



*Helping Britain run better*

# Contents

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<b>Overview</b>	01 Chairman's statement 04 Chief Executive's review 08 Group Finance Director's review
<b>Strategy</b>	13 Our Group strategic framework 14 Our strategic themes
<b>Governance</b>	20 Board of Directors 23 Corporate governance Report 33 Safety, Health and Environment Committee Report 35 Audit and Risk Committee Report 40 Nomination and Corporate Governance Committee Report 41 Policy and Performance Committee Report 42 Treasury Committee Report 43 Engaging with Members
<b>Remuneration</b>	46 Directors' remuneration report
<b>Other statutory information</b>	59 Other statutory information
<b>Financial statements and notes</b>	62 Independent auditors' report 64 Income statement 64 Statements of comprehensive income 65 Statements of changes in equity 66 Balance sheets 67 Statements of cash flows 68 Notes to financial statements

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# Chairman's statement



*"We know that our railway needs two or three decades of strategic investment if we are to meet the projected growth in demand for rail."*

Rick Haythornthwaite, Chairman

## ***Laying the foundations for our future***

***This time last year, I took the opportunity to reflect on a year of dramatic change for Network Rail, with the election of a new Government, the appointment of a new Chief Executive and a fundamental shift in its corporate ethos.***

Change in 2011/12 has undoubtedly been less dramatic, but may perhaps have more long-term significance both for the Company itself and the rail industry as a whole.

The publication in May 2011 of the final report of Sir Roy McNulty's value for money study of the rail industry, followed in March 2012 by the Government's Command Paper, have helped to set the context for the industry for the next decade and beyond. Across the industry there is consensus around the need to deliver better value both for the funding that is invested by governments on behalf of taxpayers, and for the fares paid by passengers to travel on our railway.

One also hopes that, together, they mark the end of the period of intense, yet introspective, conversation the industry has been having about its own structure and organisation.

In ruling out, correctly in my view, a radical reorganisation, the Government has helped to provide the stability necessary to allow the industry's continued evolution. In turn, this will enable it both to build on the many successes of the last decade and prepare itself to meet the challenges ahead.

Elsewhere in this report, David Higgins, Network Rail's Chief Executive and Patrick Butcher, the Group Finance Director provide details of the Company's operating and financial performance. It is worth noting that, for all the sound and fury that so often surrounds our railway, safety and financial performance are both continuing their improved trajectory. People rightly have an expectation that, whether they are travelling or working on the railway, they will get home safely. While there is never any room for complacency, especially in a year when we have been thinking so vividly of the tragedies in Essex in 2005 and Cumbria in 2007, the system as a whole continues to get safer. Rightly, there is now a huge organisational focus on the risks posed at level crossings, and David Higgins has made this one of his absolute priorities as Chief Executive.

Undeniably, however, train punctuality has been below the levels we had hoped and expected to reach by this stage of the control period. Nonetheless, it is worth putting this into some sense of perspective. We run 25,000 trains a day on the most densely used railway in the world. Passenger services account for somewhere in the region of 22,500 of these trains, and 91.6 per cent of these are on time. This is not where we wanted to be, but it is strong performance both in the context of the immediate, and less immediate, past here in Britain; and compares well with railways across Europe. There is also work to do to improve the punctuality of freight trains, though we must remain focused on what matters most to those customers.

## *Chairman's statement*

In many ways, we are dealing with the consequences of success. Demand for rail journeys is growing faster here in Britain than anywhere else in Europe. This is good news, but it does provide additional complexity as we wrestle with the multiple trade-offs inherent in our industry. Ultimately, we are trying to squeeze a 21<sup>st</sup> century railway from what remains, overwhelmingly, a Victorian structure.

With that in mind, I would like to take this opportunity, on behalf of the Board, to pay tribute to the many thousands of Network Rail's people who work each and every day to maintain and improve the service to our customers. Their task is Sisyphean, their genuine dedication to that task worthy of our unqualified admiration.

It is interesting, though, that the undoubted successes in terms of safety and performance in particular are rarely reflected in public discourse about our industry. It is clear there exists a significant gap between what the industry believes it is providing and what the wider public believes we are offering. Long-term average improvements in punctuality matter little to a specific passenger trapped on a train that is late. Efficiency savings mean little to commuters whose fares continue to rise. It is issues such as fares, seats, delays, disruptions and information that dominate our relationship with the public.

This matters, as it shapes the perception of our industry amongst the media and politicians, who understandably reflect the public's views.

We know that our railway needs two or three decades of sustained strategic investment if we are to meet the projected growth in demand for rail. This will need to come at a time when there are many deserving calls on constrained public funding. This has two implications. First, it means the railway needs to be able to attract alternative sources of funding, which is the underlying driver behind the focus on efficiencies and reform, as it is only an efficient industry that can have any reasonable expectation of attracting these alternative sources of funding.

Secondly, we must make what we believe is a strong case for investment not just to government, but to the public. Thus far, we have not taken the time to do this. As an industry, we have singularly failed to explain the big picture, and quite how much is at stake. We have failed to explain that, unless we do something now to address the looming capacity crisis on so many parts of the network, it will mean more passengers having to stand for long journeys, less reliable services than today and, undoubtedly, higher fares. Investment is essential, but we have yet to make the case for that investment to the very people whose support we perhaps most depend on.

The dichotomy at the heart of this drove my own desire to seek to begin a dialogue with the public about the place of the railways in Britain's future. This must be honest and transparent, and entirely clear about the hard choices the future may involve. It must also reflect the wider conversations already taking place, and to which the railway is undoubtedly intrinsic, about the connectedness of our communities; the prosperity of our society as a whole; and the imperative to develop a low carbon society.

In recent months, we have made some progress in beginning this conversation with the wider public, in stepping outside the closed loop in which the industry's conversations so often take place. The fascinating thing about these early stages has been the willingness of the public to engage on what are often complex and occasionally unpalatable issues.

Very soon, we will be publishing a report that sets out some of our initial work in this area, but it will be for others to take this forward, as this will be my last such statement as Chairman of Network Rail. I joined in 2009 for three years, and believe the time is right to hand the baton on. I am delighted that Professor Richard Parry-Jones will take on this mantle. He rapidly emerged from a strong field as the exceptional candidate. I know he is the right man to help steer the Company on the next stage of its journey, through further reform and the forthcoming funding settlement, which reaches its next stage in July with the publication of governments' High Level Output Specifications, and wish him every success in the role.

I would also like to take this opportunity to formally welcome Keith Ludeman to the Board, after he joined us as a Non-Executive Director in July 2011. As expected, Keith has already made a substantial contribution, and I am pleased to confirm that he will become the Senior Independent Director after the Annual General Meeting in July this year.

This vacancy has arisen after the decision by the current incumbent, Steve Russell, not to seek re-election this year. I would like to take this opportunity to thank Steve for his tireless work since joining the Board in September 2007, and particularly in the last three years as Senior Independent Director and Chairman of both the Nominations and Corporate Governance and the Remuneration Committees, roles that he has performed with intelligence, tenacity and diligence.

These changes will be complemented by the decision to appoint a Non-Executive Public Interest Director to the Board. Whoever takes on this role will be an experienced Director, expected to articulate the interests of taxpayers in Board discussions, with a strong track record in public policy, finance and corporate and social responsibility.

This new role was one element of a suite of reforms to Network Rail's corporate governance that the Company proposed to the Department for Transport and which were endorsed by the recent Command Paper. The other crucial element of these reforms is the intention to reduce the number of Public Members and remove the Industry Members, who have many other channels available to engage with the Company. This proposed reduction, which must still be endorsed at the Annual General Meeting, will allow for more effective and detailed discussion and scrutiny.

It is worth noting that the existing arrangements have overseen many tangible successes over the last decade, but the time is right for reform. These proposals reflect the outcome of a lengthy process, during which time and patience on all sides has been essential and forthcoming. I am pleased to have reached a place where these reforms have the approval of the Government, and look forward to working with Members in my remaining months as Chairman to complete the process of approval.

In summary, my belief is that both Network Rail and the industry as a whole have, over the last year, laid further solid foundations on which to build in the years to come. The industry has moved well beyond the crisis mode of a decade ago, and there is now a sense of stability that should embolden us to meet the challenges ahead. For Network Rail specifically, as it approaches its own tenth anniversary later this year, I am confident that I leave behind an exceptional team who can take the Company forward into its second decade, knowing that its greatest successes still lie ahead.



**Rick Haythornthwaite**  
Chairman  
6 June 2012

# Chief Executive's review



*"I believe Network Rail has to take the lead in opening up the industry to new levels of transparency and I hope others will follow that lead."*

David Higgins, Chief Executive

*In 2012, Network Rail embarks on its second decade as a company, and the last twelve months have underlined both the similarities and the differences in the challenges we faced then and those we face today.*

Ten years ago, following Hatfield and other fatal accidents, the railway was facing a crisis of confidence. Getting a grip of the safety and performance issues at the heart of that crisis was a major challenge. We should never under-estimate the skill, the commitment and the drive that was necessary to re-establish public confidence in the railway.

Today the challenge is different – dealing with success. Public confidence in and demand for the railway has meant that, on many of our key corridors, there are simply too many trains trying to use too little track. There are now over 1.3 billion journeys a year – the busiest the network has been since World War Two. This 'capacity crunch' is the defining challenge of Network Rail's second decade, alongside the quite legitimate demand that, as an industry, we need to become more efficient.

The scale and importance of these challenges have been behind the multiple changes which have taken place at Network Rail over the past twelve months. But as we change, we must also maintain a level of excellence in what we do – and particularly as regards safety. Ten years ago we learnt the hard way what happens when safety in the rail industry becomes a secondary consideration in the drive to cut costs. Network Rail will not repeat that mistake.

## Safety

When Network Rail was created we said that in order for passengers to be able to take safety for granted, we never can. That statement is as true today as it was then. I am proud that we have made great strides in safety and performance over the last decade, the number of broken rails – a simple and accurate measure of asset reliability – has decreased from over 800 a year to little more than 100. Today there is no safer form of transport in Great Britain and our railway is amongst the safest in Europe.

This is how it should be; but we can never afford to be complacent and we owe it to everyone – anyone who works on the railway, our customers, passengers and lineside neighbours – to work more safely each day.

This year we have been reminded of the tragic consequences of what can happen when things go wrong. Network Rail pleaded guilty for failings at Elsenham Crossing in 2005 and Grayrigg in 2007. We said sorry and we meant it. As I have said before, nothing we can say or do will lessen the pain felt by the families concerned but we will make the railways safer and strive to prevent such accidents ever happening again.

We hope this also shows a new humility in how Network Rail behaves. A willingness to admit mistakes, learn from them and be less defensive.

Underlining Network Rail's renewed commitment to safety was the appointment in 2011 of Gareth Llewellyn as Safety and Sustainability Director. Gareth's watchword is that "everyone goes home safe at the end of every day", and this is what we want to achieve. So I have given him the job of simplifying and reducing the number of standards and regulations – to make everyone who works on the railway have a clearer understanding of their responsibilities to themselves and to each other.

### *Devolution*

I believe that a company gets great results when it has great teams. Great teams work best when they have clear goals and are empowered to achieve them. In this context, the devolution of power to all of Network Rail's ten routes – completed in November 2011 – was a watershed.

This means decisions can be made more quickly, closer to the customer resulting in benefits to passengers and cost savings. Let me be clear, this is about quicker decision making and cutting costs, not cutting corners.

Devolution is for all routes and whilst there will still be central accountability and standards, routes will have more freedom to do what works in their context. But we can go further. At the beginning of 2012 we announced that we are in discussions with several train operating companies about new ways of working ever closer. We call these alliances and we hope to see these develop with every willing train operator. These will take different forms depending on the kind of railway in each area and appetite of the operator.

One example is the deep alliance which is now in operation with South West Trains (SWT). It is called 'deep' because it goes further than any other arrangements planned so far, and there are only a few places where we could potentially go this far since there is a strong geographic overlap between the route and the train operator. But I am sure that it will result in lessons which can be applied much more widely. Under this mode of working, an alliance governance board has been set up with representatives from both SWT and Network Rail. This unified management structure – under Tim Shoveller, Managing Director of the alliance team – means that the Wessex route is much more integrated with train and infrastructure operations answering to one boss.

In time, we will see what benefits this way of working will deliver and what lessons we can learn. Yet this is a concrete demonstration of the willingness of Network Rail and its customers to try – in the words of Franklin Roosevelt – 'bold persistent experimentation' – to achieve efficiencies and better service. Alliancing more generally is beginning to transform the nature of our discussions with train operators so there is much more focus on how we can help each other to deliver improved value and service which will ultimately be for the benefit of rail users and taxpayers.

What does not change in a deep alliance – or in any alliance – are the key accountabilities for which both infrastructure operator and train operator are responsible. To be clear:

- Network Rail and the train operator will remain separate entities
- employees will continue to have their current employer (with their current terms and conditions)
- each company continues to be ultimately accountable for its own areas of responsibility
- the interests of other passenger rail companies and freight operators are protected.

In particular, Network Rail will continue to be accountable for long term stewardship of the assets, operation of the network and service to all our customers.

### ***Infrastructure Projects***

Another element of empowerment relates to the way we deliver major projects. This year, under a programme we call 'Project Dime', we have prepared to move to a new, commercially focussed, regionally based projects delivery business – Network Rail Infrastructure Projects – with four regional Directors and three programme Directors responsible for delivery of major renewal and enhancement work in their area. They will manage their own profit and loss and will be charged with winning work under a new competitive structure proposed by Network Rail.

There is also a focus on developing the client capability within Network Rail to clearly define project outputs and work with delivery organisations much earlier in the project lifecycle. These changes should enable improved specification of output requirements, better integration of these requirements into our route plans and greater discipline in the interface with our delivery team. This in turn should help to facilitate greater innovation including through earlier engagement with the supply chain and through improved project-based partnerships with our customers. Moreover, where appropriate we will invite other organisations to tender for work in competition with Infrastructure Projects. This will enable us to benchmark the Company's capital project delivery, learn from others, and provide firm evidence of Network Rail's capabilities compared to its competitors.

To enable these changes and eventually to enable us to compete for business in other markets for this work, Network Rail Infrastructure Projects will need to become a separate legal entity. This is planned for 2013. Within this timeframe we will also create Network Rail Consulting, bringing further skills into our Company and further opportunities for us to benchmark against market competitors.

A concrete demonstration of the cultural change we are making in this part of our business was the awarding to Network Rail of BS11000, the new British Standard for collaborative working. Network Rail has become the first company in the rail industry – and only the thirteenth nationwide – to achieve this.

Greater collaboration between organisations within the rail industry was identified by Sir Roy McNulty as one of the means of delivering greater value for passengers and taxpayers – BS11000 is one of the tools Network Rail intends to use to improve the way it works with its supply base to drive down costs.

Five pilot projects, each demonstrating a different approach to partnership between Network Rail and its suppliers, were put forward for assessment against the standard. The BS11000 standard gives us the strategic framework to develop, with our key suppliers, the policies and processes, the culture and behaviours, required to establish successful collaborative relations and to drive continual improvement. Maintaining collaborative business relations can only lead to benefits for Network Rail and its suppliers, for the rail industry and for Britain.

### ***Rail Delivery Group***

Within the spirit of this collaboration, this year has also seen the creation of the Rail Delivery Group (RDG), which is central to the rail industry's focus on working more productively together. The group has a clear mandate to provide leadership to the industry in relation to cross-industry issues within a particular focus on identifying changes which enable the industry to deliver improved value for money. The group has made a good start and I am pleased that it has taken ownership of the significant challenges faced by the industry; I look forward to more progress and a more formal role for the RDG over the coming year.

### ***Performance and capacity***

Train performance in 2011/12 has generally been good. In fact, it is the second best year since records began. Nonetheless, during the year our regulator said we are in breach of our licence for performance on freight, and likely to be for long distance services against our exceptionally challenging targets. This is something we need to address, and we are doing just that.

To put performance in context, in ten years the industry has added over a million more train services a year, increased passenger numbers by half a billion and doubled the number of passengers arriving on time. When we took over from Railtrack fewer than eight out of ten trains arrived on time, now it's over nine out of ten.

We want to do better than that, but we have to deal with the problem of success – more trains and more passengers and freight. In fact, traffic growth is running at double the rate forecast in 2009, when our regulatory targets were set. This is the challenge the industry faces. The Government's Command Paper recognised that. We agree that there is no alternative to continued investment in greater capacity and better connectivity to meet the massive increase in passenger and freight traffic, particularly, but not exclusively, in London, where many routes are at, or approaching capacity.

### ***Transparency***

In my first day in the job I said: "I want people to associate these words with Network Rail: Open. Transparent. Accountable. Responsive." We have made moves in all of these areas. I don't want Network Rail to be seen – as it so often is – as secretive and defensive. That is why transparency is so important and being open and accountable will make us better at what we do.

To underline our commitment to transparency this year we created an important new role at Network Rail – Head of Transparency. We decided not to wait for Government to decide whether to subject Network Rail to the Freedom of Information Act 2000 and instead have committed ourselves to a programme of proactive data disclosure. The first fruits of this programme will shortly be seen.

I believe in transparency. It helps improve decision making and can drive culture change in an organisation. Given the amount of money that taxpayers put into the rail industry, it is only correct they are given the right to scrutinise what their money is paying for. I believe Network Rail has to take the lead in opening up the industry to new levels of transparency, and I hope others will soon follow that lead.



**David Higgins**  
Chief Executive  
6 June 2012

## Group Finance Director's review



*“With only two years of the Control Period remaining we are now well placed to outperform the financial targets set by the ORR.”*

Patrick Butcher, Group Finance Director

*This annual report marks the end of the third year of our five year regulatory settlement (Control Period 4). Network Rail has continued to reduce its running costs and has made significant progress in the delivery of capital works. We have restructured our business to create a platform for further improvement and with two years to go in CP4 are well placed to outperform our financial targets.*

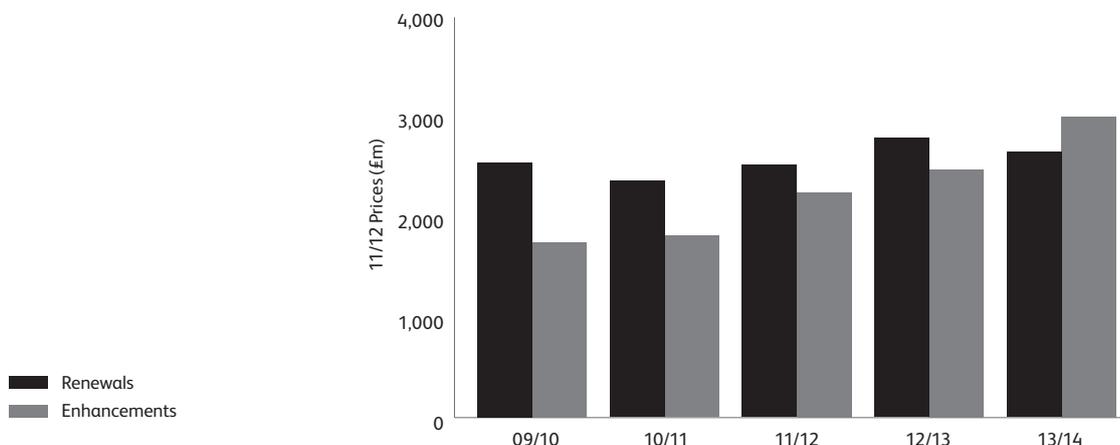
For the year ended 31 March 2012	2012 £m	2011 £m
Revenue	6,004	5,712
Operating profit	2,347	2,038
Profit after tax	761	320
Net cash from operating activities	2,691	2,486
Net debt	(27,282)	(25,056)
Net assets	7,917	7,085
Railway network fixed assets	43,112	39,577
Value of investment property	878	778
Capital expenditure	4,600	3,997

### **Progress in achieving the targets set out in the CP4 Delivery Plan**

We have recently published the third update of our CP4 Delivery Plan, reflecting performance for the Control Period so far and with updated projections to March 2014. Although we are seeing high and improving levels of train performance, this has not been enough to meet the target set by the ORR. As a consequence, in the latest update we recognise that we will not be meeting our train performance or delay minutes targets at the end of the Control Period. This is largely a result of the railway's success in attracting record numbers of passengers. The regulator has announced that, unless we do all that is reasonably practicable to improve train performance for long distance trains in 2013/14, a penalty regime will be triggered. We do expect to achieve all other regulatory targets, including asset condition and safety.

Against this backdrop, the delivery plan update indicates that we are outperforming compared to our financial plan at the beginning of the Control Period. Financial Value Added is calculated as the difference between our net expenditure in the CP4 Delivery Plan and our latest forecasts; we are currently projecting outperformance of £600m for the Control Period as a whole. Over the last two years we have paid £153m back to governments as a result of this projected outperformance.

## CP4 Investment programme



The financial targets were set on the basis of achieving year-on-year savings in maintenance, operating and renewals costs against the baseline at the beginning of CP4. We continue to do this and remain confident of achieving the required savings. Some examples of where we have changed the way we work include:

- Track renewals – delivering track renewals on some lines in mid-week nights instead of weekend blockades. Efficiencies are realised through better utilisation of labour and plant and better productivity from the same teams delivering work every day. Further efficiencies were gained by re-using materials from main line renewal sites, also contributing to environmental sustainability. This change means that more train services can run at weekends.
- Signalling renewals – replacing existing mechanical signals with lightweight or re-used signals, reducing cost and time, such as on the Salisbury to Exeter resignalling project.
- Nottingham Hub redevelopment – setting up an alliance with the train operator and the contractor, reducing cost and delivering the improvements sooner.

As can be seen from the chart above, there remains a significant challenge to deliver the balance of the CP4 investment programme over the next two years. The work will be carried out at increasing levels of efficiency and with less disruption to passengers.

## Financial review of the year

### Revenue

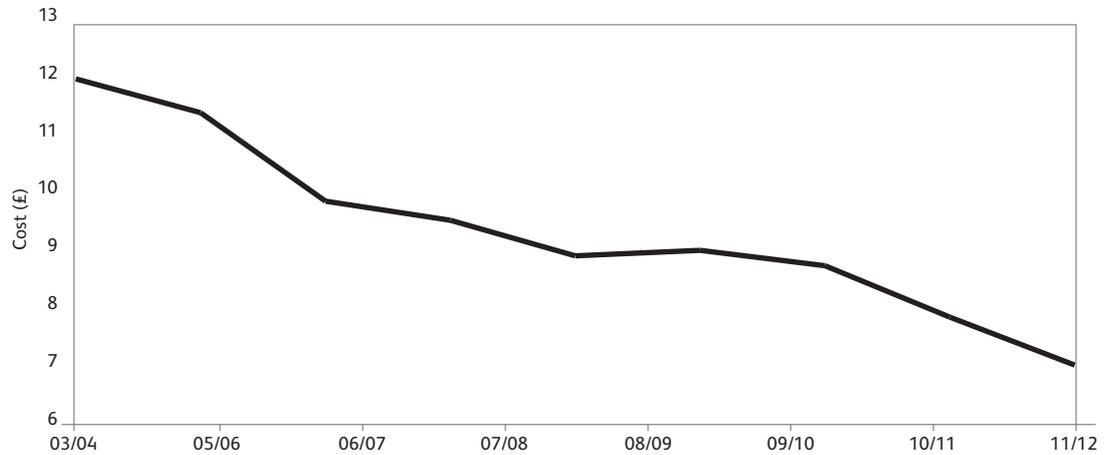
Network Rail generates the majority of its income from track access charges, revenue grants and property rental. Fixed track access charges and the revenue grant are set by the ORR and are largely fixed over the five year control period and increase in line with inflation. Turnover in the year was therefore slightly higher than last year at £6,004m (2011: £5,712m).

### Performance regime

Network Rail is expected to operate the railway reliably and the regulatory settlement sets Network Rail a target of reducing unplanned disruption year on year. When performance is not as good as assumed in the regulatory settlement and this is attributable to Network Rail, compensation is paid to train operators.

While record levels of reliability are being achieved, as mentioned above, not all the performance targets are being met. As a result, payments of £80m were made to operators in respect of unplanned delays and cancellations to services, an increase of £24m on last year. However better planning and coordination of our infrastructure works resulted in a reduction in payments in respect of planned disruption whilst carrying out more works.

Operating costs per train mile (£) (2011/12 prices)



*Property*

Rental income from the commercial estate rose from £179.4m to £179.8m for the year. Despite continuing challenges on the high street where rental growth has been flat, Network Rail's strong footfall means its retailers were able to grow sales on a like-for-like basis by 3.8 per cent. In March the new King's Cross station opened providing significant new retail space while excellent progress is being made on further new schemes including the new Waterloo balcony.

In October, Network Rail acquired Victoria Place Shopping Centre above Victoria Station for £92m. We have plans to expand and refurbish the centre to provide a more attractive, modern retail offer to better serve passengers as well as drive strong returns on our investment.

The property business has had further success in the year with its joint ventures. Solum, a joint venture with Kier Property, is close to completing its first development at Epsom station, providing new station facilities and a mixed use development totalling 166,000 sq ft, while work is now well under way on an even larger development at Walthamstow station.

*Operating costs*

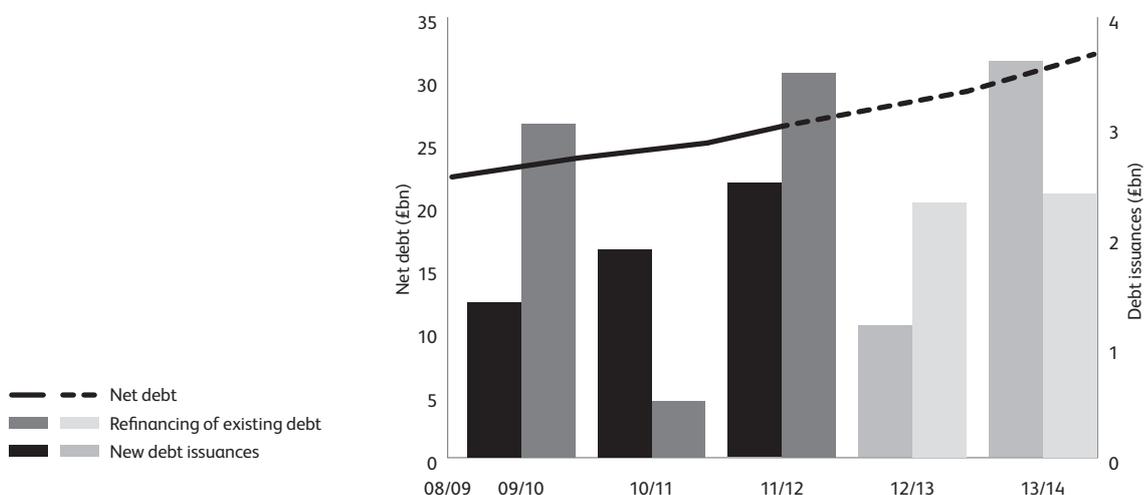
Operating costs excluding depreciation were reduced to £2,347m from £2,467m last year, while depreciation increased to £1,378m from £1,271m.

A saving of £74m was recognised following agreement to make changes to the benefits that accrue to pension scheme members. The balance of the reduction comes from the continuing drive to reduce the cost of running the railway infrastructure. Real operating costs have continued to fall, although finding areas for savings gets harder with each year alongside the pressure to run more and more reliable services on the network.

The average number of employees fell 353 to 35,253 and employee costs were down £55m at £1,679m. The depreciation increase reflects the growing asset base as a result of continued investment in railway infrastructure.

As can be seen from the chart above, in terms of operating costs per train mile, we continue the downward trajectory.

### Movement in debt over CP4



### Financial framework

Network Rail Limited is a company limited by guarantee and is the ultimate parent company of Network Rail Infrastructure Limited. There are no external shareholders and all investment is funded through the raising of debt or from operating cash flow. Debt is raised by issuing bonds through the financing vehicle Network Rail Infrastructure Finance plc.

The cost of servicing this debt is addressed as part of the regulatory settlement, whereby income for the control period is set at a level that provides a return on the regulatory asset base. Provided we meet or exceed our financial targets during the control period, we will generate enough funds from our operations to cover the interest expense.

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

In view of the indemnity, the credit rating given to Network Rail's debt is based on that of the United Kingdom Government. The ratings from the three principal rating agencies are AAA Negative (Fitch), Aaa Negative (Moody's) and AAA (Standard and Poor's).

### How much did the Group need to borrow this year?

The Group borrowed principally to fund part of its £4,600m investment programme in the year, although debt repayments of £2,545m were also made in the year.

	£m
Cash generated from operations	2,691
Capital grants	400
Borrowing to fund investment	2,572
<b>Total investment</b>	<b>5,663</b>

During the year ended 31 March 2012 Network Rail raised £5,117m of bonds under the Debt Issuance Programme. Our success in raising debt in difficult market conditions is a reflection of the existence of the financial indemnity from the UK Government and of confidence in the ability of Network Rail to service its debt.

	£m
Borrowing to fund investment	2,572
Borrowing to refinance	2,545
<b>Bonds issued in the year</b>	<b>5,117</b>

Net debt increased in the year from £25,049m to £27,281m. The chart above shows the movement in debt over CP4.

### **Summary**

In the last year we have continued to make solid progress in reducing the cost of running the railway. With only two years of the Control Period remaining we are now well placed to outperform the financial targets set by the ORR.

Performance is at a historical high but clearly there is more to be done to meet our aspirations and to reduce potential compensation payments. The next two years will see continued focus on completing CP4 for less money than the regulatory settlement, delivering the work we said we would and doing so with our assets in good and sustainable condition. At the same time we will be putting together and agreeing a robust plan for the future which will see us build on the progress achieved in CP4.

### **Looking ahead to CP5**

The Initial Industry Plan was published in September 2011 and sets out the railway industry's proposals for CP5 and beyond. The plan had a strong focus on delivering value for money and driving economic growth, recognising the efficiency challenge posed by the Rail Value for Money Study, led by Sir Roy McNulty and published in 2011.

The Initial Industry Plan sets out the options available to the funders of the railway. It will inform the development of the Government's High Level Output Specification and Statement of Funds Available, which are due to be published in summer 2012. For Network Rail the emphasis is on continuing to take cost out of the running of the railway while maintaining performance and asset condition.

Network Rail will submit more detailed proposals for CP5 as part of the Strategic Business Plan that will be presented to the ORR in January 2013.



**Patrick Butcher**  
Group Finance Director  
6 June 2012

# Our Group strategic framework

*The Executive Committee focuses on evolving and delivering the Group strategy. For 2012, the Group strategic framework has been refreshed.*

**Our purpose** (why we exist)

Network Rail exists to generate outstanding value for taxpayers and users by continually improving the railway

**Our role** (what we do)

is to develop, maintain and operate rail infrastructure in partnership with our customers, suppliers and other stakeholders

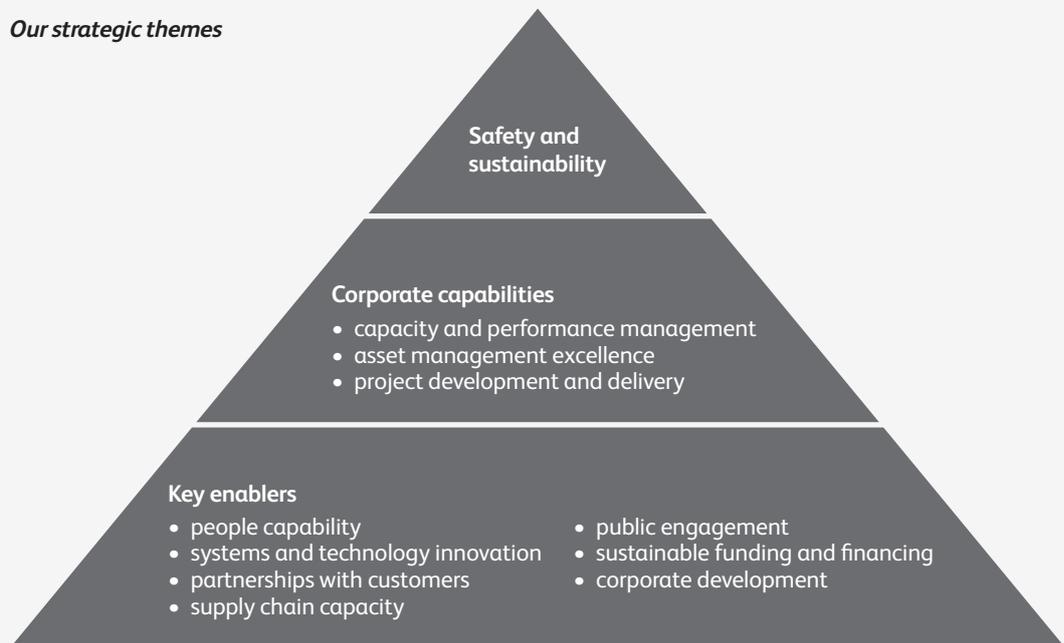
**Our vision** (how we define success)

is to be a leading independent British-based infrastructure group that is internationally respected for providing rail transportation solutions that deliver outstanding value responsibly

**Our values**

*Honesty, openness, courage and service*

**Our strategic themes**



In setting annual objectives, we are now giving all employees clear line of sight of how their objectives contribute towards our broader corporate outcomes. Our strategic themes are explained in further detail on pages 14 to 19. These themes will be further developed and outlined in our Strategic Business Plan due to be published in January 2013.

# Our strategic themes

## *Safety and sustainability*

For our business to be successful, we must maintain our focus on delivering improved standards of safety, and be sustainable in everything that we do.

### *Workforce, passenger and public safety*

The safety of those who use and work on the railway remains our number one priority.

The rail industry target is to achieve a three per cent reduction in the risk of death or injury to passengers and rail workers, as measured by the Rail Safety and Standards Board's Safety Risk Model. We measure our input to achieving the above industry targets principally through the Passenger Safety Indicator and Workforce Fatalities and Weighted Injuries Indicator. The Passenger Safety Indicator is currently well ahead of plan and we are on course to meet our plan for the end of Control Period 4 (CP4) (2009/10 – 2013/14). The Workforce Fatalities and Weighted Injuries measure is currently behind our plan for the end of CP4 (which was set significantly ahead of the industry target) and, although achievement of the plan is still possible, this will require significant improvement on current performance.

We pleaded guilty over safety breaches in relation to the fatalities at Elsenham level crossing in 2005 and the derailment at Grayrigg in 2007. Both were serious events where people lost their lives. We have learned lessons from both incidents and put our learnings into practice.

We are continuing our programme of level crossing risk reduction and early indications are that this has delivered a 10 per cent reduction in level crossing risk since the end of Control Period 3 (CP3) (2004/05 – 2008/09). We have also created a level crossings fund using £89m of our expected outperformance during CP4. This fund will be used to accelerate delivery of safety improvements or closure at the highest priority level crossings.

Our Safety Leadership and Culture Change Programme is well under way with a planned set of activities including a clear and concise safety and wellbeing vision and the introduction of lifesaving rules.

## *Sustainability*

We remain committed to sustainable development, with the aim of driving efficiency, building trust and creating long-term value for stakeholders through responsible business practices. There are relevant policies, standards and guidelines in place to manage the Company's economic, social and environmental impacts.

The inclusion of sustainable development in the Initial Industry Plans for England and Wales and Scotland, demonstrates the industry's commitment and ambition for sustainable development. The Company also continues to participate in cross-industry initiatives such as the Sustainable Rail Programme, facilitated by the Rail Safety and Standards Board.

### *Sustainable business strategy*

During the year, we established a new Safety & Sustainable Development (S&SD) function and merged the existing Corporate Responsibility and Environment Policy teams. The new S&SD function is leading the development of a Company-wide sustainable development vision and strategy which will be implemented in 2012/13.

Specific focus will be on buildings, land, resources, water and emissions and how we adapt to climate change. As well as putting in place company wide strategies in these areas, the team will work to support the Company's business units to integrate sustainable development into operational priorities.

Changes to our governance structure for sustainable development have also been made during 2011/12. This year has seen the end of our Corporate Responsibility Group (CRG), which provided strategic leadership on emerging issues in the area of sustainability and corporate responsibility. The group, which met four times in 2011/12, was chaired by the Chief Executive and included a combination of senior team members, functional representatives, area specialists and an employee representative. The role of the CRG will be incorporated into the new governance structure for the S&SD function during 2012, specifically within the Sustainable Development Improvement Group.

We did not submit an entry into the most recent Business in the Community Corporate Responsibility Index (an annual benchmarking survey which measures corporate responsibility performance) and which we have taken part in for the past four years, achieving a rating of gold in 2010/11. No entry was made this year as the Company re-evaluated its position in line with its emerging sustainable development vision and strategy.

A snapshot of performance on environmental sustainability is given below.

#### *Environmental sustainability*

##### *Carbon*

In 2011/12, our total carbon footprint was an estimated 310,670 tonnes CO<sub>2</sub>e, a slight increase from last year (2010/11: 309,932 tonnes CO<sub>2</sub>e).

##### *Managing waste*

In 2011/12 we managed approximately 1,506,618 tonnes of waste, of which approximately 84.8 per cent was diverted from landfill. This waste comes mainly from our construction and track renewal and maintenance work, but also from our stations, offices and other operational sites such as depots and signal boxes.

A further 786,536 tonnes of waste were managed by contractors on our infrastructure and asset management projects, of which 85.9 per cent was diverted from landfill.

In 2010/11, we introduced challenging targets for some of our waste contractors to help us reduce the amount of waste that we generate and minimise the amount we send to landfill. Recycling rates at our managed stations have already improved, reaching 54.6 per cent (2010/11: 28.8 per cent).

A full Sustainability Update will be published later in 2012 and will be available at [www.networkrail.co.uk](http://www.networkrail.co.uk).

## ***Corporate capabilities***

Performance against our corporate capabilities – our competencies that contribute to our long-term success – are explained in further details below.

### ***Capacity and performance management***

While we are achieving record levels of reliability, we are not meeting all our CP4 targets. Our regulator (the Office of Rail Regulation (ORR)), has found that we are in breach of our licence in relation to freight performance, and that we are likely to be in breach of our licence in respect of long distance punctuality. The ORR has issued two enforcement orders requiring us to work closely with the industry to produce robust plans to further improve long distance performance with specific focus on 2012/13 and to establish a 'recovery board' (now in place) at which our freight customers can require us to take specific measures to tackle performance for freight services.

While we have not achieved our performance targets in Scotland, the ORR has accepted that the existing timetable has been a significant contributor to this failure and we will work with both Transport Scotland and First ScotRail to develop a more resilient timetable to be implemented over the next two years.

Reflecting this challenging position, our forecasts show that we are now likely to miss our end of control period regulatory performance targets for Public Performance Measure (PPM) on long distance services, freight delay minutes per 100 train km and delay minutes in England and Wales. We have worked closely with train operators to finalise Joint Performance Improvement Plans (JPIPs) for the final two years of CP4. The JPIPs for long distance services indicate that we will not achieve the end CP4 PPM target of 92 per cent, but that we will improve punctuality from 89.1 per cent to at least 90 per cent.

While recovery of performance for freight will take time, we believe that it is achievable. We are therefore continuing to review opportunities to accelerate this improvement and are discussing with freight operators how we can help to provide a better service to their customers. In Scotland we are working with First ScotRail and Transport Scotland to address long-term inconsistencies in the timetable. Performance in Scotland will also be affected by the extent of severe weather over the next two years.

## Our strategic themes

### How do we measure success?

In the tables below key performance targets are set out. Further details can be found in CP4 Delivery Plan Update 2012 at [www.networkrail.co.uk](http://www.networkrail.co.uk)

### CP4 outputs

Passenger train punctuality (per cent)	2011/12		2010/11	
	Target	Actual	Target	Actual
England & Wales	92.0	91.7	91.5	90.9
Long distance	90.9	89.1	89.8	87.7
London and South East	92.4	91.7	92.0	91.1
Regional	91.5	92.5	91.0	91.5
Scotland	91.7	90.7	91.3	90.1

Cancellations and significant lateness (per cent)	2011/12		2010/11	
	Target	Actual	Target	Actual
Long distance	4.2	3.99	4.5	5.00
London and South East	2.1	2.38	2.2	2.61
Regional	2.4	1.96	2.5	2.44
Scotland	1.8	2.42	1.9	2.65

Note: Scotland figures are not regulatory targets.

Passenger train services ('000s delay minutes)	2011/12		2010/11	
	Target	Actual	Target	Actual
England and Wales	5,430	6,517	5,790	6,859
Scotland	391	480	410	541

Freight services (delay mins per 100 train km)	2011/12		2010/11	
	Target	Actual	Target	Actual
Great Britain	3.18	3.57	3.41	4.29

### Asset management excellence

Although there are no regulatory targets related to our asset stewardship, we have internal targets which are also reviewed by the ORR. Whilst the measures we monitor are better overall than last year and well in excess of those envisaged at the start of the Control Period, we expect have missed our internal asset stewardship targets for 2011/12. This was largely because track condition has been below target due to the impact of the long period of dry weather during 2011. This position is now improving, reflected by improvements in track geometry and fewer rail breaks and serious rail defects. Our forecasts for the asset stewardship measures are consistent with delivering the required outputs in a way that is both sustainable and consistent with good long-term stewardship of our assets. We have developed a joint understanding with the ORR of what is required to achieve excellence in asset management.

### Project development and delivery

We have committed to deliver the projects specified in the governments' high level output specifications for England and Wales, and Scotland. We will also deliver other projects which will provide the infrastructure required to meet the disaggregated England and Wales capacity specifications. The scope, outputs and milestones for each enhancement programme are summarised in the separate supporting document 'CP4 enhancements programme', which is updated on a quarterly basis.

We continue to deliver our large scale CP4 projects, including Thameslink, Reading, Birmingham New Street and London King's Cross, amongst others. The Thameslink programme has made good progress, with the delivery of infrastructure works on time in December 2011, enabling the first 12-car trains to be introduced. A further £200 million of expenditure on the Thameslink project is being deferred to Control Period 5 (CP5) (2014/15 – 2018/19). In Scotland, we have substantially completed the Paisley Corridor improvements programme.

We have also started to involve suppliers earlier in the delivery of projects and to develop more collaborative working arrangements with them and started the process of making our infrastructure projects division more of a separate business open to outside competition.

## Our key enablers

Performance against the key enablers we believe to be critical to our success are explained in further detail below.

### People capability

#### Leadership

Over the year we have moved to strengthen the leadership team. There have been a number of changes within the Executive Committee and senior management as a whole, strengthening our management team to meet the challenges facing the Group.

We have refined our strategic vision and are working on how we are going to achieve our vision by refreshing our Company values and behaviours.

#### People profile

We are one of the largest employers in the country. We currently have around 34,600 staff.

Our workforce is relatively mature and stable. More than 21 per cent have been with the Group for over 20 years and 12 per cent have less than two years' service. The average age is 42. Many of our staff have spent their entire careers at Network Rail.

Our workforce is mainly represented by the RMT union with around 6,000 members. In terms of diversity, women represent 13 per cent of the workforce and

we are seeking to increase this proportion. Five per cent of our employees are from black and minority ethnic (BME) backgrounds\*.

Women represent 13 per cent of our Executive Leaders (the most senior managers in Network Rail). 67 per cent of our Executive Leaders are white, 0 per cent BME and 33 per cent have not disclosed their origin.

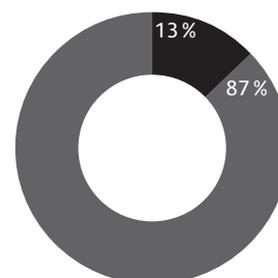
We believe that there are further opportunities to drive diversity at levels below the Board, both within the organisation and particularly within senior management. We are focussing on identifying opportunities for improving how we manage diversity and inclusion (D&I) in our workplace.

In the latter part of 2011 we commissioned independent research into D&I at Network Rail, surveying around 3,000 employees and conducting focus groups. The findings have been shared with all employees. Key themes are our recruitment practices, behaviours, and attitudes towards minorities, particularly disabilities. We are drafting a D&I policy and a plan of action, having engaged a highly experienced D&I expert to support us. Immediate actions have included the open advertising of all vacancies and increased training for all recruiting managers.

### Diversity across the Group

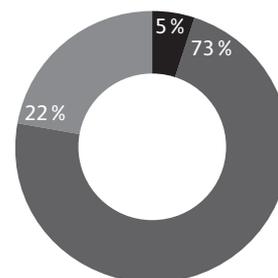
#### Female workforce as at 31 March 2012 %

Female employees	■
Male employees	■



#### Black and minority ethnic\* workforce as at 31 March 2012 %

BME	■
Non-BME	■
Unclassified	■



\*BME consists of employees that do not begin with White in their origin, Non-BME consists of all employees that begin with White in their origin. Approximately 22 per cent of employees have not declared their origin.

## *Our strategic themes*

### *Employee engagement*

We conduct an annual independently-run survey of our employees in order to monitor progress in improvements in the way we manage and develop our people, how we lead the business and the way in which we work. With a response rate of 67 per cent the results showed overall employee engagement had neither improved nor declined against last year's results – 3.84 against 3.85 last year. The results also highlighted some areas of focus which we are addressing. Over the course of 2012 we will increase focus on employee engagement at all levels of the organisation.

### *Communication*

We recognise the value of good communication in engaging our employees in order to achieve common goals and we have a number of established employee communication mechanisms in place to achieve this goal, including the Group's intranet site, management information cascades and briefings, films, internal magazines, email news bulletins and business briefings. Business briefings are held annually, across the country, in May at which employees are able to attend and question the Directors on any aspect of the business that they choose.

### *Recruitment and training*

We are committed to offering all our employees a fulfilling and challenging career in an environment free from discrimination, harassment, victimisation and bullying irrespective of their gender, sexual orientation, marital status, race, nationality, ethnic origin, disability, age, religion or union membership status. Our policies and procedures in recruitment and selection, training, career development, working arrangements, promotion and performance appraisal support this commitment. Moreover we continue to work with trade unions in the area of equality of opportunity and development of policy to promote best practice within the business. Our equal opportunities policy is communicated to employees.

We are committed to providing high quality training and development initiatives to ensure we are equipped to deliver excellence in all we do. Substantial investment is 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.

### *Career progression*

We actively encourage development from within. Our talent identification and succession planning processes are now being embedded across the business and our intention is to ensure we develop our internal pool of talent so we can resource roles internally wherever possible. To support this we now offer a suite of specific programmes to develop key individuals.

### *Systems and technology innovation*

As part of our investment in the future of the rail industry, our rail innovation and development centre provides facilities for engineers and operators to experiment and develop new ways of maintaining, renewing and enhancing the railway. The centre is open to the wider industry and supports a wide range of activities for our colleagues across the industry. Engineers are trained to develop and improve their skills in a realistic and safe environment.

As part of the Network Rail Partnership Awards, we recognise partners who have created innovative ways of overcoming problems we face in our day-to-day operations. These include new ways of working, cutting-edge technologies or novel approaches to benefit users.

We also run an innovation and suggestion scheme, through which we are empowering people from all parts of the rail industry to share their novel ideas.

### *Partnerships with customers*

During the year, we accelerated our plans for increasing local accountability at route level and improving alignment with train operators and implemented our devolution proposals to form ten operating routes in November 2011. We are making progress with our plans to form alliances, initially with six train operators. The aim is to enable faster decisions, and have more focus on passengers, as well as lowering costs. Discussions continue with all other operators on how we can work more closely together and these may lead to further alliance agreements. We are also discussing the opportunity for further alliances as part of refranchising.

Various approaches are used to monitor the satisfaction of customers, rail users and other stakeholders. Independent relationship surveys are conducted regularly with customers, passengers and freight end users. The results of the 2011 survey of customer satisfaction (passenger and freight operators) shows that overall satisfaction is slightly down on last year with freight operator improvements more than offset by a decline in passenger operator satisfaction, the main factor being deterioration in satisfaction with train service performance.

In order to improve our approach to customer service, we are developing a customer service maturity model which we will trial on a pilot basis later this year in order to assess its suitability for wider application.

In addition, we have a Stakeholder Relations Code of Practice which is firmly aligned with the ongoing programme of creating a service culture within the Company. The Code can be found at [www.networkrail.co.uk](http://www.networkrail.co.uk)

#### *Supply chain capacity*

We spend circa £4.5bn annually on works, services and bought-in goods. Fifty per cent of our total expenditure is with our top 20 suppliers. We are committed to maximising the value delivered from every supplier with whom we deal.

Every year a supplier survey is undertaken to better understand perceptions of Network Rail and this includes procurement practices. Many of the comments received have been acted on through a significant programme of transformation. We have achieved five primary actions detailed as follows:

- completed a review of Purchase to Pay processes and implementation of iProcurement
- developed a strategic sourcing process to manage commercial activity consistently
- launched a supplier account management process for key suppliers
- reviewed the qualification and assurance processes
- refreshed our standard suite of contracts.

Each of these is a significant project in its own right and demonstrates clearly our commitment to improving supplier relationships.

#### *Public engagement*

Information on the steps we have taken, during the year, to engage with the public about the place of railways in Britain's future and the need for continued long-term investment in the railway can be found on page 2.

The moves we have made during the year to be more open, transparent and accountable are outlined on page 7. In addition, we have increased local accountability at route level enabling us to have more focus on, and engage more effectively with, our passengers and other stakeholders.

#### *Sustainable funding and financing*

In September 2011, the rail industry published separate Initial Industry Plans for England and Wales and Scotland. These set out the industry's views on the choices and trade offs in outputs and expenditure for CP5, as well as setting out how the industry can deliver a more efficient and better value railway and how the railway can play a key role in driving sustainable economic growth. We also provided the ORR with analysis of Network Rail's initial forecasts of activity and expenditure in CP5. These plans were informed by Sir Roy McNulty's value for money study of the rail industry, which identified significant opportunities for the industry to reduce its costs.

The ORR has published its Advice to Ministers. Later this year, Governments (England and Wales and Scotland) will publish their High Level Output Specifications (HLOSs) and Statements of Funds Available.

Taking into account all this information, we will publish the Strategic Business Plan for CP5 and beyond in January 2013. This will provide our response to Governments' HLOSs, setting out our view of the costs to deliver the required outputs based on a strategy that has been developed by the rail industry.

#### *Corporate development*

We have made various changes to our business to bring us closer to our customers and allow us to demonstrate better value-for-money including:

- forming alliances with the train operators
- increasing local accountability at route level
- making changes to the way we deliver major projects.

More information can be found on these changes on pages 5, 6 and 18.

# Board of Directors



## **1. Rick Haythornthwaite** *Chairman*

Rick Haythornthwaite, 55, has been the Company's Non-Executive Chairman since July 2009 having joined the Board in March 2009 as a Non-Executive Director. He was Chief Executive of Invensys plc, from 2001 to 2005. He was also previously Group Chief Executive of Blue Circle Industries and spent 18 years with BP in various senior roles. He is currently Non-Executive Chairman of MasterCard Inc, a Senior Advisor to STAR Capital Partners and President of PetroSaudi International (UK) Ltd. His previous non-executive roles included Board membership of ICI, Land Securities and Lafarge. In the voluntary sector, he is Chairman of the Southbank Centre and Chairman of the World Wide Web Foundation. Rick will retire from the Board at the Company's annual general meeting (AGM) on 19 July 2012.

*Appointed 23 March 2009*

## **2. Richard Parry-Jones** *Chairman Designate*

Richard Parry-Jones, 60, joined the Board in March 2012 as Chairman Designate. His appointment as Non-Executive Chairman of Network Rail will be put to Members at the Network Rail's AGM in July 2012. Richard Parry-Jones joined Ford Motor Company as an apprentice before becoming Group Vice President Global Product Development and Group Chief Technical Officer. Currently he is a Senior Independent Director of GKN plc and a Non-Executive Director of Cosworth Group Holdings as well as being Council Member of the Royal Academy of Engineering and of Bangor University. He is Pro-Chancellor of Loughborough University and a visiting Professor in the Faculty of Engineering. He also co-chairs, with Vince Cable, the UK Automotive Council. He is a Fellow of the Royal Academy of Engineering, the Institution

of Mechanical Engineers and the Royal Society of Statistical Science. In 2005, Richard was awarded a CBE, for his services to the automobile industry.  
*Appointed 28 March 2012*

## **3. David Higgins**

*Chief Executive*  
David Higgins, 57, joined the Board in April 2010 as a Non-Executive Director and took up the role of Chief Executive on 1 February 2011. He is also a Non-Executive Director of Sirius Minerals Plc. He was appointed Chief Executive Designate of the Olympic Delivery Authority in December 2005 and appointed Chief Executive with effect from 30 March 2006 and held this role until January 2011. Prior to December 2005, he was Chief Executive of English Partnerships for three years. His early career was at Lend Lease Group, where he was appointed Managing Director and Group Chief Executive in 1995. David graduated in Civil Engineering from the University of Sydney and holds a diploma from the Securities Institute of Australia.  
*Appointed 1 April 2010*

## **4. Patrick Butcher**

*Group Finance Director*  
Patrick Butcher, 44, had his responsibilities expanded during the year to include Legal Services, Information Management and Human Resources, in addition to his existing portfolio of Finance, Property and Procurement. Patrick previously held the position of Finance Director at English Welsh and Scottish Railway (now DB Schenker (UK)) between 2004 and 2008. Before this he was Finance Director at Mapeley Ltd, London Underground and King's College Hospital. His early career was at Deloitte & Touche, as a Management Consultant and Auditor. Patrick is a Member of the Institute of Chartered Accountants (South Africa).  
*Appointed 20 April 2009*

## **5. Robin Gisby**

*Managing Director, Network Operations*  
Robin Gisby, 55, joined the Board in 2008, having been employed by Network Rail and its predecessor, Railtrack, since 1997. During the year his position changed, in response to devolution, taking responsibility for the day-to-day operation and maintenance of the national rail network, including local asset management. Robin is therefore responsible for delivering a safe railway and for the safety of its passengers. Previous roles in the Company include Director, Operations and Customer Services and two regional Director positions. Within Railtrack, Robin was Director, Network Development and Director, Freight. Before joining Railtrack Robin held engineering and operational roles in both the UK and overseas mainly with GKN PLC. He has a first degree in Engineering Science and an MBA. He is a chartered engineer and a Fellow of the Chartered Institute of Transport.  
*Appointed 1 October 2008*

## **6. Peter Henderson**

*Group Asset Management Director*  
Peter Henderson, 58, has responsibility for central asset management and asset information. He has over 25 years' rail experience. He began his career with the construction of the Tyne and Wear Metro and then spent 16 years with the Hong Kong Mass Transit Railway Corporation as Head of Major Projects. He returned to the UK in 2000 to work for Bechtel where he was Projects and Engineering Director for Rail. He has an MSc in Engineering Business Management. In November 2011, Peter announced his intention to leave Network Rail.  
*Appointed 3 October 2002*



**7. Simon Kirby**  
*Managing Director,  
 Infrastructure Projects*  
 Simon Kirby, 46, joined the Board in 2008, having been with the Company since 2003. He is responsible for delivery of all large enhancement and renewal infrastructure projects. During the year, Simon has been involved in creating a new rail projects business within Network Rail to provide a benchmark for Network Rail services against external competition. Previously, Simon held positions in the defence industry and has been involved in a number of land and naval weapons system projects including the Trident Nuclear Submarine Programme. In 2000, he was appointed Managing Director of three BAE Systems shipyards before, in 2002, becoming Managing Director of the BAE Systems Type 45 Prime Contract Organisation. Simon is also on the Board of the Major Projects Association. He has an MSc in Engineering Business Management from Warwick University and is a Fellow of the Institute of Civil Engineers and of the Association of Project Management.  
*Appointed 1 October 2008*

**8. Paul Plummer**  
*Group Strategy Director*  
 Paul Plummer, 46, joined the Board in 2008, having been with the Company since 2002. He is responsible for development of the Company's strategy, network planning, the development of enhancement projects, the periodic regulatory review process, reform of the regulatory and contractual framework and regulatory, government and European affairs. In December 2011, his remit was broadened to include leading industry planning and coordination through the Rail Delivery Group. Paul was Chief Economist and Director of Economics and Finance at the Office of Rail Regulation from 1999



to 2001. He has also worked at National Economic Research Associates (NERA), NM Rothschild and Accenture advising companies, governments and regulators on utility regulation, restructuring, privatisation, strategy, finance and mergers and acquisitions in the UK and overseas. He has a degree and MSc in Economics.  
*Appointed 1 October 2008*

**9. Malcolm Brinded**  
*Non-Executive Director*  
 Malcolm Brinded, 59, was an Executive Director of Royal Dutch Shell plc until 1 April 2012. He has had a distinguished career with Shell; appointed an Executive Director of Shell in October 2004 responsible for global exploration and production and from July 2009 Executive Director for Upstream International. He was previously a Managing Director of Shell Transport from March 2004 and, prior to that, a Managing Director of Royal Dutch from 2002. In 2002, he was appointed CBE for services to the UK oil and gas industry. He is currently a Non-Executive Director of CH2M Hill, a Chairman of the Shell Foundation and a UK Business Ambassador.  
*Appointed 12 October 2010*

**10. Graham Eccles**  
*Non-Executive Director*  
 Graham Eccles, 65, joined the Board following an extensive career in the railways. Graham's former positions include Deputy Chairman of London Midland, Chairman of the South East Strategic Health Authority, Board Member of Stagecoach Group plc, Chairman and Managing Director of South West Trains and Co-Chairman of Virgin Rail Group Ltd. He is also Chairman of Virgin Healthcare Holdings Limited.  
*Appointed 7 February 2010*



**11. Mike Firth**  
*Non-Executive Director*  
 Mike Firth, 69, was previously Head of Corporate Banking at HSBC Bank plc until his retirement in September 2002. He is also a Non-Executive Director of Communis plc and Henderson European Focus Trust plc. He was previously a Non-Executive Director of Somerfield plc and First Technology PLC. Mike is an Associate of the Chartered Institute of Bankers and a Fellow of the ifs School of Finance.  
*Appointed 4 December 2004*

**12. Lawrie Haynes**  
*Non-Executive Director*  
 Lawrie Haynes, 59, is President – Nuclear at Rolls-Royce plc. He was previously Chief Executive at White Young Green plc. Prior to that, he was Chief Executive of British Nuclear Group and a main Board Director of BNFL plc. He was also Chief Executive of the Highways Agency. He is currently on the Board of Trustees of the Royal Air Force Benevolent Fund and is Chairman of its Remuneration Committee. Lawrie holds a degree in Business Law and an honorary doctorate in Engineering (2010) both from Heriot Watt University. He is a Fellow of the Chartered Institute of Logistics and Transport.  
*Appointed 26 January 2010*

## Board of Directors



13



14



15



16

### **13. Janis Kong**

#### *Non-Executive Director*

Janis Kong, 61, is a Non-Executive Director of Kingfisher plc, Portmeirion Group PLC, VisitBritain, TUI Travel PLC and Copenhagen Airport Board. Janis is also Chairman of the Board of Trustees of Forum for the Future. During her 33-year career with BAA, Janis held a number of operational roles and, until her retirement in March 2006, was a Director of BAA plc and Chairman of both Heathrow Airport Ltd and Heathrow Express. Prior to that, she was Managing Director of Gatwick Airport. She was previously a Non-Executive Director of The Royal Bank of Scotland Group PLC. *Appointed 13 January 2010*

### **14. Keith Ludeman**

#### *Non-Executive Director*

Keith Ludeman, 62, will become Senior Independent Director, following the Company's AGM on 19 July 2012. He was Group Chief Executive of the Go-Ahead Group plc from July 2006 to July 2011 having previously been a Group Executive Director since 2004 and a main Board Advisor since 1998. Before this he held senior management positions in bus companies, mainly at Managing Director level. He has also worked as a transport consultant. He was appointed Chief Executive of the Go Ahead's London bus division in 1997, before moving across to manage the rail division in 1999. He was Chairman of Association of Train Operating Companies between 2003 and 2005, a member of the British Transport Police Authority until 2005. He is currently a Non-Executive Director at Interserve Plc and Chairman of the Bristol Water Company. He is a Fellow of the Chartered Institute of Transport & Logistics and a Fellow of the Institute of Railway Operators. *Appointed 5 July 2011*

### **15. Bridget Rosewell**

#### *Non-Executive Director*

Bridget Rosewell, 60, is Senior Partner of Volterra, producing economic analysis across a range of sectors. She is also a Non-Executive Director and Chair of the Risk Committee at Ulster Bank. Between 2002 and 2012 she was Chief Economist and Chief Economic Advisor to the Greater London Authority. Prior to that she was Executive Chairman of Business Strategies Ltd – subsequently sold to Experian. She was a founder of Oxford Economic Research Associates (Oxera) and previously held a position as an Economics Adviser to Chancellor Kenneth Clarke. Her transport experience includes preparing economic analysis for train operators, Crossrail and London & Continental Railways. She was previously a Non-Executive Director and Chair of the Audit Committees for both the Department for Work and Pensions and Britannia Building Society. *Appointed 20 January 2011*

### **16. Steve Russell**

#### *Non-Executive Director and Senior Independent Director*

Steve Russell, 67, joined the Board in 2007 and was appointed Senior Independent Director in July 2009. He was Chief Executive of Boots Group PLC between 2000 and 2003, working there since he started his first job at the company in 1967. He was a Non-Executive Director of Barclays PLC – where he was a Member and Chair of the Audit Committee and Member of the Risk, Nomination, and Governance Committees. He is Chairman of Business Control Solutions plc and is also a Trustee of St John Ambulance and Tommy's, the baby charity. Steve will not be standing for re-election as a Non-Executive Director at the Company's AGM on 19 July 2012. *Appointed 19 September 2007*

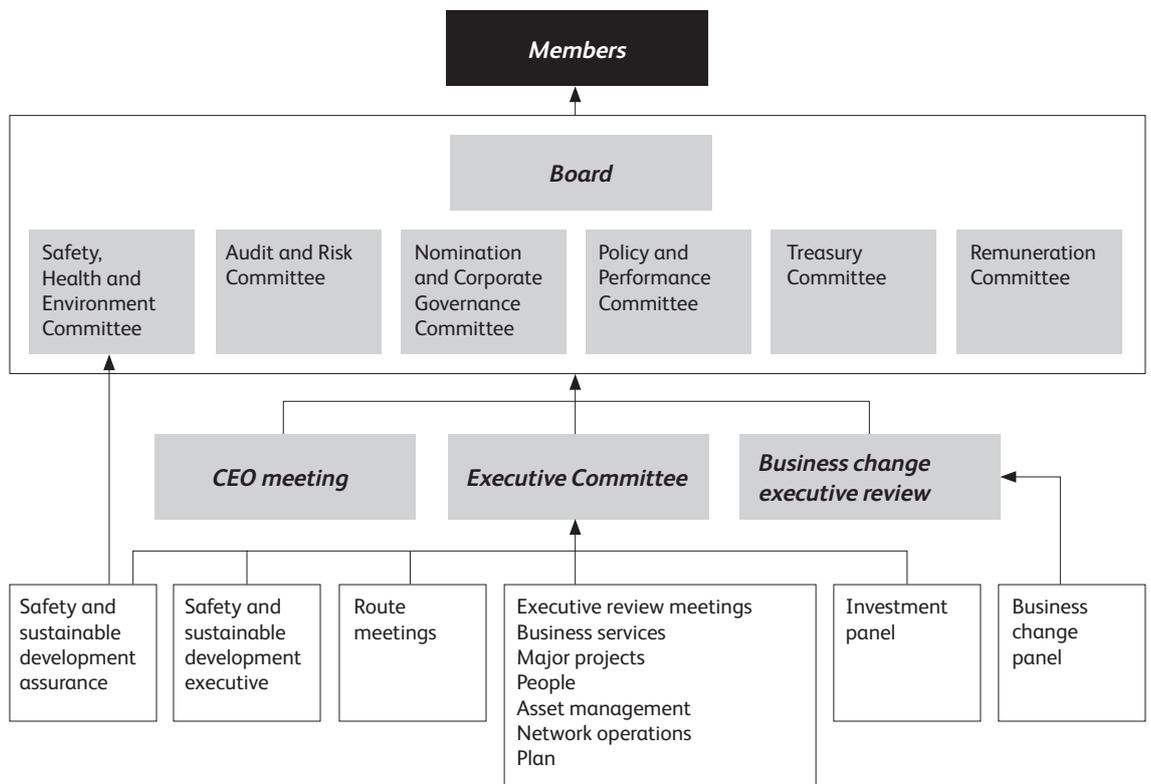


*“The Board is committed to high standards of business behaviour not only in the boardroom but across the business.”*

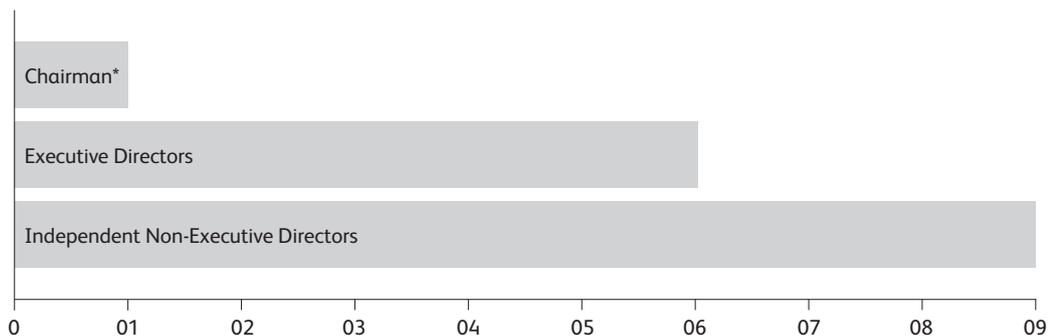
**Compliance with the provisions of the UK Corporate Governance Code**

The following report details how the Board has applied the principles in the UK Corporate Governance Code (the Code). The Directors consider that Network Rail has complied with the Code throughout the year.

**Summary Board and committees structure**



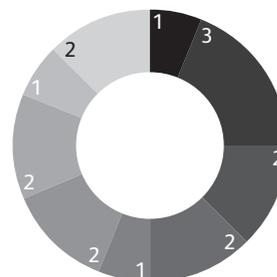
**Board composition as at 31 March 2012**



\*independent on appointment

### The Board's background as at 31 March 2012

Customer service	■
Engineering	■
Finance	■
Generalist	■
Projects	■
Operational	■
Railway	■
Safety	■
Strategy	■



#### Who is on the Board?

Biographies of the Directors who have served during the year are provided on pages 20 to 22.

#### What changes have been made to the Board during the year?

The following changes have been made to the Board during the year:

- Richard Parry-Jones was appointed to the Board on 28 March 2012 as Chairman Designate following the announcement by Rick Haythornthwaite of his intention to resign as Chairman. Richard will become Chairman subject to Members' approval at the Annual General Meeting (AGM) in July 2012. The Board considers that Richard is independent from Network Rail. Details of the selection process are detailed in the Nomination and Corporate Governance Committee report on page 40.
- Keith Ludeman was appointed as a Non-Executive Director on 5 July 2011
- Steve Russell announced that he would not stand for re-election as a Non-Executive Director and the Senior Independent Director at this year's AGM. Keith Ludeman will become Senior Independent Director after the AGM.
- Peter Henderson announced his intention to leave Network Rail during 2012.

In light of these changes, the chairmanship of the Board committees were reconsidered and the following changes will take effect after the AGM in July 2012:

- Audit and Risk Committee – Bridget Rosewell
- Nomination and Corporate Governance Committee – Keith Ludeman
- Policy and Performance Committee – Keith Ludeman
- Remuneration Committee – Graham Eccles.

#### Are all the Directors subject to annual election/re-election by the Members?

Yes, all the Directors will be presented to Members for election/re-election at the AGM except those who have announced their intention to resign.

#### Do any of the Directors have conflicts of interest?

The Company has procedures for managing conflicts of interest. Directors are required to submit any potential or actual conflicts that they may have with the Company to the Board for approval and Directors have continuing obligations to update the Board on any changes to their conflicts. In addition, Directors complete an annual disclosure of conflicts using a questionnaire.

At no time during the year did any Director hold a material or any other interest in any contract with the Company or any of its subsidiaries other than service agreements between Executive Directors and the Company and letters of appointment between Non-Executive Directors and the Company, save that the reimbursement of expenses and cost of secretarial services for the Chairman was made by payment of £20,000 (2011: £21,000) to R H Management Limited, in which he has material interest.

The Directors have not needed to exercise their powers to authorise any conflict of interest of any Director of Network Rail during 2011/12.

#### What is the role of the Board?

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

## Corporate governance report

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

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

Certain matters are formally reserved for decision by the Board. These include approval of:

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

### How does the Board allocate its time?

Board meetings are designed for focus on safety, health and environment matters, strategy, current operational and financial performance and governance and risk management.

### Board allocation of time expressed as a percentage during 2011/12

Strategy	■
Safety	■
Operational	■
Financial and investment	■
Governance and risk management	■

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

Below is a chart which summarises the approximate time the Board has spent discussing agenda items at Board meetings during the year.

### What is the role of the Non-Executive Directors?

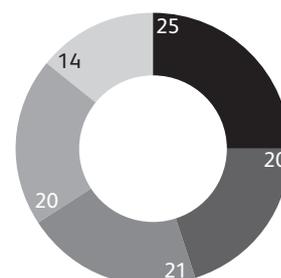
The Non-Executive Directors bring independence, external skills and challenge. Their independence is critical for providing assurance that the Executive Directors are exercising good judgment in delivery of strategy and decision-making.

The Non-Executive Directors combine broad business and commercial experience from the rail and other industry sectors enabling them to:

- challenge and contribute constructively to the development of Group strategy
- scrutinise the performance of management in meeting agreed objectives
- monitor operational performance of the business.

Careful consideration has been given to the composition of the Non-Executive Directors with the aim of maximising the breadth of skills and experience as well as the mix of individuals holding executive positions and those who have retired from full-time employment in other companies (recognising the respective time commitment opportunities of both). Information on the skills and experience can be found in the biographies on pages 20 to 22.

The Board considers that each of the Non-Executive Directors is independent of the Company. With regard to the guidelines on the meaning of 'independence' as set out in the Code, it is appropriate to disclose that Graham Eccles receives a pension from the Railway Pension Scheme (RPS). Over 100 companies from the rail industry participate in RPS. The scheme is run by independent trust managers, with trustees drawn from across the membership of the scheme, including other companies within the scheme. Given this structure, the Board considers that Graham Eccles is independent, as Network Rail is only one of many contributing companies to RPS.



## *What are the roles and responsibilities of the key Board members and the Company secretary?*

### **Role of the Chairman**

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The Chairman is responsible for creating the conditions for the effective working of the Board and is specifically responsible for the following:

- chairing Board meetings and setting the agenda for such meetings, taking full account of the views and concerns of all Directors and encouraging their active engagement in Board discussion
- promoting the highest standards of corporate governance, including compliance with the Code wherever possible
- promoting the requirement that all Board members are exemplars of the Company's values, principles and standards
- through the Nomination and Corporate Governance Committee, ensuring that the Board comprises individuals with an appropriate mixture of skills, experience and knowledge
- ensuring that the Company maintains effective communication with Members, and that their views and any concerns are understood by the Board
- working with the Chief Executive to ensure that the Board receives accurate and timely information on the performance of the Company
- representing the Company at the highest level and, in conjunction with the Chief Executive, developing strategic relationships with major customers and political leaders worldwide
- leading the evaluation of the performance of the Board, its committees and individual Directors
- establishing an effective working relationship with the Chief Executive, providing support and advice whilst respecting executive responsibility
- ensuring that a well constructed induction programme is provided for new Directors, that all Directors have the opportunity to develop their understanding of the Company and that they are kept informed of matters affecting the Company.

### **Role of the Senior Independent Director**

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The Senior Independent Director is responsible for the following:

- being available to Members if they have concerns which contact through the normal channels of Chairman, Chief Executive or other Executive Directors has failed to resolve or for which such contact is inappropriate
- providing a sounding board for the Chairman and serving as an intermediary for the other Directors when necessary
- providing feedback on the Chairman's performance as derived from the evaluation exercise undertaken by the Board
- chairing a meeting with the Non-Executive Directors without the Chairman present at which the Chairman's leadership of the Board is discussed.

### **Role of the Chief Executive**

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The Chief Executive is responsible for the leadership and management of the Company within the strategy and business plan agreed by the Board.

The Chief Executive is specifically responsible for the following in respect of his relationship with the Board:

- developing a business strategy for the Company to be approved by the Board on an annual basis
- producing business plans for the Company to be approved by the Board on an annual basis
- overseeing the management of the executive resource and succession planning processes, and presenting annually the output from these to the Board and Nomination and Corporate Governance Committee
- ensuring that effective business and financial controls, and risk management processes are in place across the Company and that all relevant laws and regulations are complied with
- making recommendations to the Board on the appropriate delegation of authority within the Group
- keeping the Board informed regularly as to the performance of the Company and bringing promptly to the Board's attention all matters that materially affect, or are capable of materially affecting, the performance of the Company and the achievement of its strategy
- developing for the Board's approval appropriate values and standards to guide all activities undertaken by the Company
- providing clear and visible leadership in business conduct
- promoting the requirement that all senior leaders are exemplars of the Company's values, principles and standards
- owning the Company's commitment to all aspects of corporate responsibility.

### **Role of the Company Secretary**

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The General Counsel acts as the Company Secretary and is specifically responsible for the following:

- under the direction of the Chairman, ensuring good information flows within the Board and its committees and between senior management and Non-Executive Directors, as well as facilitating induction activities for Directors and assisting with their development as required
- advising the Board through the Chairman on all governance matters.

Full statements of responsibility for the Chairman, Chief Executive and Senior Independent Director are published on Network Rail's website.

**What is the time commitment expected of the Chairman and what are his other significant commitments?**

The Chairman's contractual commitment to the Group is two days per week although, since his appointment, his actual level of activity has exceeded this. The Chairman has confirmed that the performance of his outside responsibilities continue to be achieved without detriment to his duties to Network Rail and he anticipates this will remain so until the AGM, where he will not be standing for re-election. His main interests outside the Company are set out in his biographical details on page 20.

As part of the selection process for the new Chairman, the Nomination and Corporate Governance Committee reviewed the existing commitment of Richard Parry-Jones and he confirmed that the performance of his outside responsibilities would be achieved without detriment to his duties to Network Rail.

**What are the Directors paid?**

Details of Directors' service contracts, letters of appointment and remuneration can be found in the remuneration report on pages 46 to 58.

**Does the Company maintain directors' and officers' liability insurance?**

Yes, the Company maintains directors' and officers' liability insurance which gives appropriate cover for legal action brought against Directors.

**What commitment has the Company made to diversity and inclusion at Board level?**

Network Rail is committed to maintaining a work environment in which a diverse range of talented people work together to improve business performance. In 2011, an independent report was commissioned into the diversity and inclusion (D&I) at Network Rail and this has led to D&I becoming an area of strategic focus, as Network Rail strives to improve its performance in this business critical area.

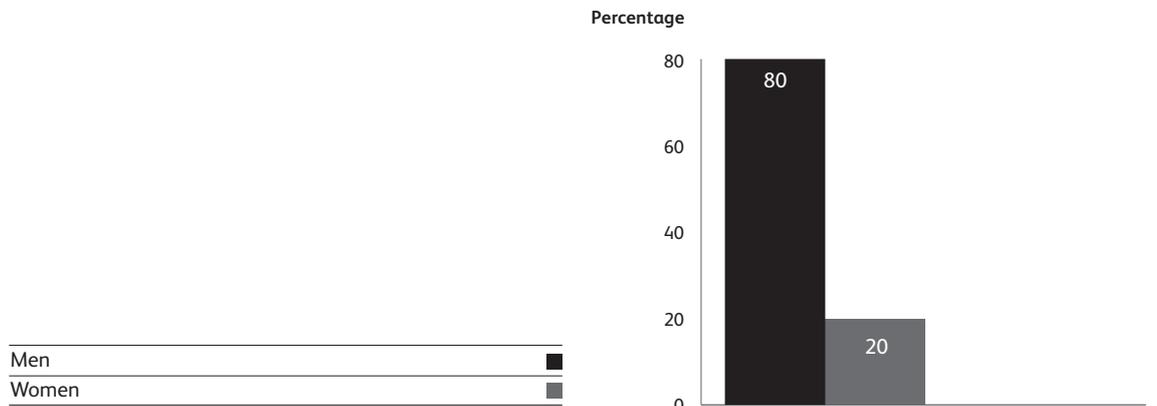
The Board seeks to maximise its effectiveness by bringing together people with the right mix of skills, knowledge and experience. Diversity, in all its aspects, is an important element in the composition of a Board.

Appointments shall always be made on the basis of merit and seek to leverage the benefits of diverse talent. With regard to gender diversity the Board has agreed the following:

- in seeking candidates for appointment to the Board, the Nomination and Corporate Governance Committee will only engage the services of search consultants who have open and inclusive recruitment processes that draw from an appropriately diverse pool of candidates
- it will have an aspirational target of at least 25 per cent of the Non-Executive Directors being women by 2015
- through its regular reviews of management succession planning it will oversee the effectiveness of the actions being taken by management to ensure that the composition of the executive leadership team reflects the entirety of the management talent pool available within the Company and the wider market.

Initiatives under way in the Company to drive diversity at all levels below Board are set out on page 17.

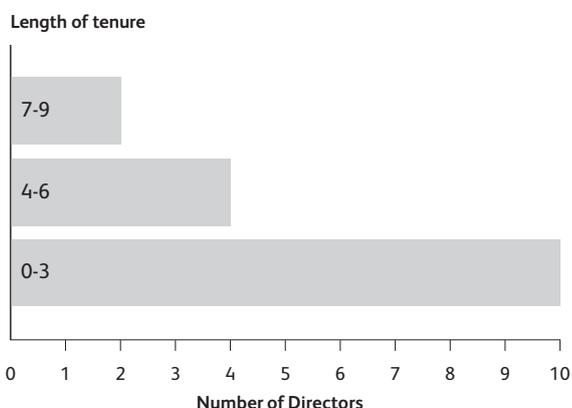
**Split of men to women Non-Executive Directors on the Board as at 31 March 2012**



**What is the length of tenure of Directors?**

The Board believes it is important to maintain an appropriate balance between length of service and a broad range of skills, expertise, industry knowledge, diversity of opinion and contacts relevant to the Company's business. The non-executive element of the Board has been strengthened in the last two years with seven new Directors appointed between 2010 and 2012. They join the existing two Non-Executive Directors to form a highly experienced and challenging team working closely with Executive Directors in the leadership of Network Rail.

**Length of tenure on the Board as at 31 March 2012**



**Does the Company have an induction programme for new Directors?**

**A typical Director's induction programme in 2011/12**

<p><b>Operational site visits:</b></p> <ul style="list-style-type: none"> <li>• <b>Thameslink</b> – Blackfriars and London Bridge site tours</li> <li>• <b>King's Cross/London Bridge or St Pancras</b> – tour with Station Manager and visit to a signal box</li> <li>• <b>Milton Keynes</b> – visit to see the new central office for key operational functions</li> <li>• <b>Route Tour</b> – to meet route control, maintenance delivery unit and training centre teams.</li> </ul>	<p><b>Internal meetings held with:</b></p> <ul style="list-style-type: none"> <li>• each Non-Executive Director</li> <li>• each Executive Committee member</li> <li>• other senior management, including                             <ul style="list-style-type: none"> <li>– Director, Property</li> <li>– Group Treasurer</li> <li>– Head of Risk and Insurance</li> <li>– Head of Internal Audit.</li> </ul> </li> </ul>	<p><b>External meetings held with:</b></p> <ul style="list-style-type: none"> <li>• key customers and their representatives (train and freight operating companies)</li> <li>• Chair and Chief Executive of the Office of Rail Regulation (ORR)</li> <li>• Secretary of State for Transport</li> <li>• Members' Co-ordinator.</li> </ul>
<p><b>Briefing on company secretariat matters with General Counsel:</b></p> <ul style="list-style-type: none"> <li>• Board level governance</li> <li>• Director's duties</li> <li>• Members</li> <li>• management incentive plan</li> <li>• major litigation.</li> </ul>	<p><b>Induction with Safety and Sustainable Development Director on:</b></p> <ul style="list-style-type: none"> <li>• safety related matters</li> <li>• safety management system</li> <li>• Directors' responsibilities.</li> </ul>	<p><b>Any other site visit/meeting considered pertinent for fulfilling the role</b></p>

## Corporate governance report

### *How does the Board keep up-to-date with business developments?*

Directors are encouraged to update their skills, knowledge and familiarity with the Group through ongoing participation at Board and committee meetings, and meetings with senior managers and other employees. Briefings are given to the Board by members of senior management and external stakeholders on key projects, organisational functions, governance or assurance processes and safety management. During the year, presentations were made to the Board, on High Speed 1, National Delivery Service and the London Olympics 2012. The Board also held its annual strategy day.

### *How does the Board keep up-to-date on key governance issues?*

The Board believes that keeping up-to-date with developments in corporate governance is important for its effective functioning. The General Counsel prepares a Board paper each quarter and presents updates on regulatory and governance related matters with other briefing papers being tabled as necessary. During the year the Board has been briefed on: future of narrative reporting and executive remuneration, Lord Davies Report – Women on Boards and the Bribery Act 2010.

### *How does the Board and its committees remain effective?*

The Nomination and Corporate Governance Committee is charged by the Board to review annually the performance of the Board, its principal committees and individual Directors.

For 2011/12 the evaluation process was conducted externally by an independent consultant, Deloitte LLP. The evaluation assessed the collective performance of the Board and each of its committees as well as the contribution, effectiveness and commitment to the role of each of the Directors (including commitment of time for Board and committee meetings and any other duties).

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

- Board performance against the aspirations contained within the Code and Network Rail's Governance Principles set out on [www.networkrail.co.uk](http://www.networkrail.co.uk)
- functional effectiveness of the Board and its committees including the effectiveness of the processes by which the Board is held to account by its stakeholders.

### Summary of Board development plan

	Key findings	Actions	Progress update
<b>Board dialogue</b>	Increased focus of Board discussions	Continue to identify key strategic agenda items for 2012	Complete
		Review time spent on Board agenda items over a six month period	Ongoing
	Extent and effectiveness of challenge amongst Board Directors to be further enhanced	Tailored business briefings and site visits for Non-Executive Directors	In progress
		Time in Field to be increased	In progress
<b>Board reporting</b>	Nature of information provided to the Board	Review training requirements with committee chairs	Complete
		Board papers to be reviewed by Executive Committee before submission to the Board meeting	Complete
	Dialogue between the Board and its Committees	Board input to be sought on content of Board agendas	Ongoing
		Written reports to be provided to the Board by all committee chairs	Complete
<b>Board committees</b>	Relationship between the Committees	Provision of a 'Resource Area' for Directors to view detailed reports for 'deep dive' reviews	Complete
		Annual review by the committees of their role, nature of information provided to them and support requirements	Complete
		Preparation of forward agendas for the Board and its committees	Complete

***Do the Directors have access to independent professional 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. In addition, all Directors have access to the advice and services of the General Counsel.

***How frequently did the Board meet during the year?***

The Board has adopted a timetable of eight scheduled Board meetings each year with additional meetings being arranged where necessary. The Board generally meets at the Company's head office in London but at least two meetings a year are held at different national locations, giving the Directors the opportunity to visit the sites and meet a cross-section of employees and community stakeholders. During 2011/12, the Board met stakeholders of Birmingham, Blackfriars and Gravesend.

Attendance by Directors at Board and committee meetings during 2011/12 is set out in the table below:

	Board	Safety, Health and Environment	Audit and Risk	Nomination and Corporate Governance	Policy and Performance	Treasury	Remuneration
Number of meetings held	8	7	4	1	6	3	12
<b>Attendance</b>							
Rick Haythornthwaite	8/8	N/A	N/A	1/1	6/6	N/A	11/12
Richard Parry-Jones <sup>A</sup>	N/A	N/A	N/A	N/A	N/A	N/A	N/A
David Higgins	8/8	N/A	N/A	N/A	N/A	N/A	N/A
Patrick Butcher	8/8	N/A	N/A	N/A	N/A	N/A	N/A
Robin Gisby	8/8	N/A	N/A	N/A	N/A	N/A	N/A
Peter Henderson	5/8	N/A	N/A	N/A	N/A	N/A	N/A
Simon Kirby	8/8	N/A	N/A	N/A	N/A	N/A	N/A
Paul Plummer	8/8	N/A	N/A	N/A	N/A	N/A	N/A
Malcolm Brinded	7/8	6/7	N/A	N/A	N/A	N/A	N/A
Graham Eccles	8/8	7/7	N/A	1/1	5/6	N/A	10/12
Mike Firth	8/8	N/A	4/4	N/A	N/A	3/3	12/12
Lawrie Haynes	7/8	7/7	4/4	N/A	4/6	N/A	N/A
Janis Kong	8/8	7/7	4/4	1/1	N/A	N/A	N/A
Keith Ludeman <sup>B</sup>	5/5	N/A	3/3	N/A	4/4	N/A	N/A
Bridget Rosewell	8/8	N/A	N/A	N/A	6/6	N/A	N/A
Steve Russell	8/8	N/A	N/A	1/1	5/6	3/3	12/12

A Appointed to the Board on 28 March 2012

B Appointed to the Board on 5 July 2011

**Notes**

- 1 All Directors are expected to attend Board and those committee meetings of which they are members. Processes are in place for minimising Directors' non-attendance. The occasions where circumstances prevented a Director from attending a meeting were as a result of illness and existing conflicting diary commitments, especially in respect of Directors newly appointed during the year or changes to the composition of the committees.
- 2 Where a Director is unable to attend a meeting, the Director will be provided with the papers and given the opportunity to discuss his comments with the Chairman prior to the meeting.

***Does the Chairman meet with the Non-Executive Directors in the absence of the Executive Directors?***

The Chairman holds regular scheduled meetings with the Non-Executive Directors without the Executive Directors present to discuss the performance of the Company under the executive leadership. In 2011/12 the Non-Executive Directors met separately from the Executive Directors on three occasions.

***What is the role of the Executive Committee?***

Whilst the Board is ultimately responsible for the success of the Company, given its size and complexity of its operations, all operational management is on a delegated basis to the Chief Executive and the executives working for him. The Chief Executive and five Executive Directors have specific responsibilities for key parts of the business. They provide the Non-Executive Directors with a wider and more immediate view of operational issues and prevent views and perception from becoming dominated by a single executive voice. During the year, the responsibilities for some of the Executive Directors were broadened to anticipate key business changes. Details of these new responsibilities are provided in the Board biographies on pages 20 to 22.

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

***What committees does the Board have?***

The Board has six committees which assist in the discharge of its responsibilities:

- Safety, Health and Environment Committee
- Audit and Risk Committee
- Nomination and Corporate Governance Committee
- Policy and Performance Committee
- Treasury Committee
- Remuneration Committee.

Details of these committees and their activities during the year are set out on pages 33 to 42.

## Safety, Health and Environment Committee Report



**Lawrie Haynes**  
Chairman, Safety, Health and Environment Committee

### Who is on the Committee?

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

### Who attends meetings of the Committee?

The Chief Executive, Group Asset Management Director, Managing Director, Network Operations, Managing Director, Infrastructure Projects, Safety and Sustainable Development Director and Head of Risk attend the meetings by invitation.

Representatives from the Company's trade unions have been invited to attend the meetings. Mick Cash, Senior Assistant General Secretary of the RMT, is currently attending Committee meetings. Mick participates in, and introduces topics for discussion by the Committee. This aids scrutiny and challenge and enhances transparency of the work of the Committee.

During the year, Ian Prosser, Head of Safety for the ORR, attended a meeting to present the regulator's view on the Company's safety performance during the year.

Ian Tyler, Chief Executive of Balfour Beatty plc, was invited to attend a Committee meeting. Ian presented Balfour Beatty's stance on contractor safety and their perspective on working for Network Rail in respect of safety.

### How many meetings were held during the year?

The Committee met seven times during the year.

### What is the role of the Committee?

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 Group, taking into account relevant standards and requirements.

The Committee's responsibilities include:

- monitoring the Group's safety, health and environment policies and strategies
- considering 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
- reviewing the scope and results of any safety, health and environment audit, the effectiveness of the respective audit policies and strategies, the audit's cost effectiveness and the independence and objectivity of the audit body
- considering the major findings of internal and external investigations and management's response and, where necessary, making recommendations to the Board in respect of the same.

## Corporate governance report

### *What were the principal activities of the Committee during the year?*

The Committee's activities in 2011/12 included (but were not exclusive to):

#### **Leadership**

- oversaw the safety, leadership and culture programme within the Company, receiving reports on activities undertaken and progress made during the year.
- oversaw the changes to the governance of safety and sustainable development matters within the Company including the new approach to safety risk and assurance.

#### **Performance**

- received periodic reports, from the Safety and Sustainable Development Director, on the safety, health and environment performance of the Company on:
  - workforce safety
  - passenger safety
  - public safety
  - system safety precursors
- received oral briefings on safety performance on their areas of responsibility from the Group Asset Management Director, Managing Director, Network Operations, and Managing Director, Infrastructure Projects.

#### **Risk management**

- received regular updates on progress being made by the Company in key areas including:
  - progress made with the programme to reduce risk and improve safety at level crossings which is being led by the National Level Crossing Team
  - trends in irregular working events which can be defined as the failure to carry out tasks and procedures in the prescribed manner
  - safety risk aspects and principal processes used to manage structures including earthworks assets
  - status of the recommendations arising from the Rail Accident Investigation Branch Investigation into the derailment at Lambrigg, near Grayrigg, Cumbria on 23 February 2007
  - risks associated with devolving accountability to the routes and the mitigating actions taken.

#### **Learnings from incidents**

- reviewed learnings derived from incidents and near misses.

The Committee recognised the efforts made by the management team but remains concerned about performance trends.

#### **Lawrie Haynes**

Chairman

Safety, Health and Environment Committee

## Audit and Risk Committee Report



**Mike Firth**  
Chairman, Audit and Risk Committee

### Who is on the Committee?

Current members	From
Mike Firth* (Chairman since January 2006)	December 2004
Lawrie Haynes	November 2010
Janis Kong	January 2010
Keith Ludeman**	July 2011

\* Mike Firth has a strong and lengthy financial background with experience of chairing listed company's audit committees. He is also a Fellow of the ifs School of Finance and an Associate of the Chartered Institute of Bankers.

\*\* Appointed as a Non-Executive Director in July 2011.

### Who attends meetings of the Committee?

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

### How many meetings were held during the year?

The Committee met four times during the year.

### What is the role of the Committee?

The Committee has been delegated authority by the Board to:

- review 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)
- monitor financial reporting policies and practices and compliance with accounting standards
- review significant accounting estimates and judgments
- review interim and annual financial statements before publication

- consider and make recommendations to the Board in relation to the appointment, reappointment and removal of the external auditors following its assessment of their independence and objectivity (including the safeguards that are in place to maintain such independence) and their terms of engagement and remuneration
- review the internal and external audit process including the scope of the planned audits and the audit findings
- review the policy and procedure whereby employees can raise, in confidence, concerns about possible improprieties
- oversee the process for the identification and management of risk.

During the year the terms of reference for the Committee were updated, and approved by the Board, and the Committee was renamed the Audit and Risk Committee to take into account its role in respect to risk management.

The Committee's terms of reference are available on the Network Rail website: [www.networkrail.co.uk](http://www.networkrail.co.uk)

### What were the principal activities of the Committee during the year?

#### Internal controls and risk management

- considered reports from the external auditors, PricewaterhouseCoopers LLP (PwC), and the internal audit function on work undertaken in reviewing and auditing the control environment
- reviewed risk management reports, identifying high level risks and the status of mitigation, current risk profile, changes to the profile during the year and considered the progress that has been undertaken in relation to the several strategic risks
- reviewed the risk management systems associated with devolution
- provided oversight, on behalf of the Board, of the review undertaken in the response to 'Resolution 24'; a resolution proposed and approved by Members at the 2011 AGM, whereby the Non-Executive Directors were asked to conduct a review into the Company's internal audit, investigatory and response processes
- assessed the effectiveness of the Group's internal controls and reviewed the related disclosures in the Annual Report
- reviewed the policy and procedure whereby employees can raise, in confidence, concerns about possible improprieties.

**Financial reporting**

- reviewed the financial statements and the significant financial reporting judgements contained within them
- reviewed the basis for preparing the Group accounts on a going concern basis
- reviewed the financial statements in the 2011/12 Annual Report, and the 2011 Half-yearly Report, and received a report from PwC on the statements
- reviewed ARUP's audit plan for the 2011/12 regulatory accounts, including scope of audit and proposed fees
- reviewed the regulatory accounts for 2010/11.

**Internal audit**

- agreed the internal audit programme for 2012/13
- agreed the appointment of a new Head of Internal Audit
- reviewed output from, and considered progress against, the internal audit programme four times during the year
- reviewed the effectiveness of the Group's internal audit function.

**The external auditors**

- agreed the approach and scope of the audit work to be undertaken by the external auditors
- reviewed with the external auditors the findings of their work
- reviewed the Group's processes for disclosing information to the external auditors and the related statement in the 2011/12 Annual Report
- agreed the fees payable in respect of the 2011/12 audit work
- reviewed the nature and cost of non-audit work undertaken by the external auditors in 2011/12
- received confirmation from the external auditors regarding their independence.

**What is the role of internal audit function?**

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

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

**How are external auditor objectivity and independence safeguarded?**

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

In 2011/12 the fee for audit services was £0.4m. The fee for non-audit services was £0.2m which was in respect of the regulatory accounts 'audit', the interim review of half-year results, the secondment of two individuals in a project management role on Orbis and support around the controls and security of the Oracle R12 project.

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

The Committee has responsibility for advising the Board on the appointment, reappointment and the remuneration of the external auditors. PwC have been the Group's external auditors since 2010. In May 2012 the Committee recommended to the Board that PwC be presented for reappointment as the Company's auditors at the AGM in July 2012. The Board accepted the recommendation and the re-election of PwC as the Group's external auditors will be proposed at the 2012 AGM.

The risk management and internal control structure is detailed opposite.

**Mike Firth**  
Chairman  
Audit and Risk Committee

## **Risk management and internal controls**

### *What are the Board's responsibilities for risk management?*

The successful management of risks is essential to enable the Group to deliver its strategic objectives. We have an established governance structure which supports the early identification and mitigation of key business risks.

Whilst the ultimate responsibility for risk management rests with the Board, it delegates the more detailed oversight of risk management and internal control principally to the Audit and Risk Committee which reports the findings of its reviews to the Board. The Board has considered and approved the risk management policy, risk appetite of the Group and has delegated the regular review of the risk management process to the Audit and Risk Committee. The Audit and Risk Committee receives regular reports from the internal and external auditors and reviews progress against agreed action plans.

The Audit and Risk Committee is supported in carrying out role by the following Committees:

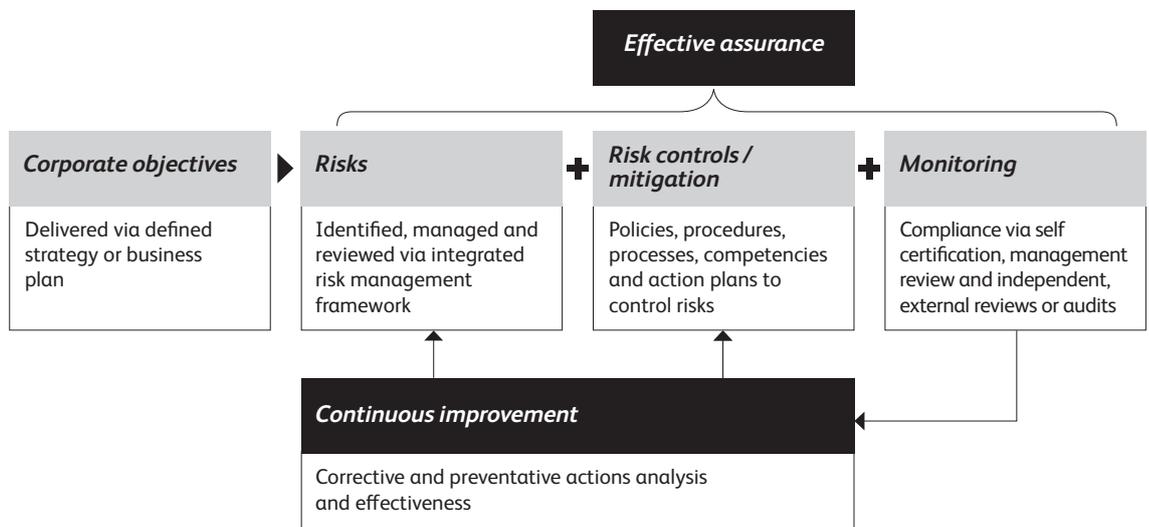
**Safety, Health and Environment Committee** – reviews the integrity of the methods of discharge of the safety, health and environmental responsibilities of the Company and satisfies itself as to the adequacy and effectiveness of the safety, health and environment policies and strategies within the Group.

**Treasury Committee** – monitors the effectiveness of treasury controls and the appropriateness of proposed treasury transactions.

**Executive Committee** – executive management is responsible for designing, implementing and monitoring the operation of the system of internal control and for providing assurance to the Executive Committee which regularly reviews all key risks identified by functional management.

### *What is our risk management process?*

Our risk control framework operates as follows:



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

- the identification of risks to the achievement of corporate and business objectives by the Executive Committee and 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
- the capture and recording of risks, risk scoring and action plans in a company-wide risk management system
- the regular review of executive risks by the Executive Committee and regular reporting and review of business unit and major project risks by the Executive Directors at monthly business reviews
- the regular review and reporting of the Company risk profile by the Audit and Risk Committee and the Board, including regular attendance by Executive Committee members at the Audit and Risk Committee to deliver assurance on their risks
- the inclusion of risk assessment into business change governance and investment planning processes using the corporate risk matrix scoring system.

***Does the Group maintain a risk register?***

Each member of the Executive Committee is required to maintain a risk register which includes the key risks that have been identified, their potential impact and likelihood of occurrence, the risk owner, action plan and action owner.

Bi-monthly, the Executive Committee reviews the executive risk register and assesses progress on the implementation of mitigation strategies along with consideration of new and emerging risks.

Once reviewed by the Executive Committee, the executive risk register is presented to the Audit and Risk Committee for consideration.

See page 39 for details on the Group's principal risks.

***What are the aims of the internal control system?***

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 Audit and Risk Committee, on behalf of the Board, keeps the effectiveness of the system of internal control under review and has done so throughout the year.

There are established internal control procedures for managing the risks faced by the Group.

***How are internal controls monitored and reviewed?***

The internal audit function provides independent assurance on the adequacy and effectiveness of the system of internal control.

Following each internal audit, a report is produced showing the findings which are reported to senior management and any corrective action is agreed. Summaries of these reports and details of progress against action plans are presented to the Audit and Risk Committee at each meeting for discussion and review.

In accordance with the Turnbull Guidance, an annual review of internal controls is conducted. The Board has delegated authority to the Audit and Risk Committee to regularly monitor internal controls and conduct the annual review. This review covers all material controls such as financial, operational and compliance, and also risk management systems in place throughout the year under review.

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 its internal control 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.

### What are the Group's principal risks?

Principal risks managed through the framework include:

Description	Impact	Mitigation
<p><b>Safety</b> The risk of death or injury from accidents on the railway for passengers, rail workers and members of the public remains Network Rail's number one consideration in everything we do. Potential causes of such accidents include infrastructure failures, level crossing misuse, irregular working, defects in traction and rolling stock, trespass, objects on the line and vandalism.</p>	<p>If deemed to be within Network Rail's control, civil or criminal liabilities resulting in significant costs, including fines and penalties, and loss of licence or regulatory enforcement action could arise, together with significant damage to reputation.</p>	<p>Work has continued during the year to identify opportunities to improve safety performance, including the intelligent infrastructure maintenance programme; level crossing improvement plan, structured review of the effectiveness of the Health and Safety Management System and workforce safety culture and behaviour initiatives.</p>
<p><b>Performance</b> Our ability to deliver the timetable (our promise to our customers) can be impacted by many factors, both within and outside of our control. For example, adverse weather conditions; loss of business critical resources; acts of external parties all have the potential to cause severe business interruption.</p>	<p>An inability to service customer requirements, with the potential for loss of licence or regulatory enforcement action, together with significant damage to reputation.</p>	<p>We are accountable for managing the industry's train performance improvement plans. Under the auspices of the National Task Force we work closely with the train operators via the Joint Performance Improvement Plan process to identify and mitigate risks to operational delivery. We also manage the industry's response to extreme weather and major external incidents.</p>
<p><b>External environment</b> Network Rail operates in a highly regulated environment and is exposed to significant risk from changes in political agendas.</p>	<p>Failure to influence our key stakeholders or the political agenda has the potential to undermine the Company's long-term objectives through the imposition of unachievable regulatory settlements; changes to our operating licence and/or Company structure.</p>	<p>Engagement at the highest level with the Government, Department for Transport, Transport Scotland and the Office of Rail Regulation.</p>
<p><b>Network enhancement</b> We are committed to delivering a number of complex, high value infrastructure enhancement projects, which we must do safely, to specification, on time and within budget.</p>	<p>Increased costs and regulatory enforcement action could arise, together with damage to reputation.</p>	<p>All projects are managed using a life cycle management process known as Governance for Railway Investment Projects (GRIP) which controls the progress of a project through detailed stage gates. A comprehensive approach to programme and risk management is deployed on all major projects which includes comprehensive programme controls using latest Oracle business systems measuring cost and schedule performance. Project risk management is deployed as part of this process and tracked each period using Active Risk Manager.</p>
<p><b>Finance</b> We have agreed a financial settlement for the current control period which we must use to deliver the regulatory outputs. To do this, we must identify and realise significant levels of cost efficiencies across the Company.</p>	<p>Failure to deliver the investment, asset management and operational activity required to meet our regulatory outputs, leading to regulatory enforcement and damage to reputation.</p>	<p>A robust business planning process that identifies actions required to deliver efficiencies, together with a series of monthly management reviews that monitors progress and identifies corrective action where necessary.</p>
<p><b>People</b> We have a number of substantial organisational changes going on within the Company, throughout which we must maintain an appropriately skilled, motivated workforce by developing a working environment in which people feel committed to operate safely and to deliver high performance.</p>	<p>Industrial disputes leading to inability to service customer requirements. Inability to retain or recruit appropriately skilled staff.</p>	<p>Managing engagement with trade unions; providing clear communications with the workforce; maintaining a high status of readiness of contingency plans to manage local and national threats; actively managing key players across the business.</p>

## Nomination and Corporate Governance Committee Report



**Steve Russell**  
Chairman, Nomination and Corporate Governance Committee

### Who is on the Committee?

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

### Who attends meetings of the Committee?

The Committee asks the Chief Executive and Director, Human Resources to attend certain of its meetings.

### How many meetings were held during the year?

Although the Committee met only formally once during the year, the members of the Committee (other than Rick Haythornthwaite) met a number of times to tackle the recruitment of the new Chairman. Rick Haythornthwaite recused himself from the process of recruiting the new Chairman.

### What is the role of the Committee?

The role of the Committee includes:

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

During the year, the Board approved extension of the remit of this Committee to encompass corporate governance, with the Committee being tasked with assisting the Board on matters related to the effective

governance of the Company which includes reviewing and making recommendations to the Board on corporate governance best practice.

### What were the principal activities of the Committee during the year?

#### Recruitment of new Chairman

Following Rick Haythornthwaite's decision not to stand for re-election at the 2012 AGM, the Committee commenced the search process for finding a new Chairman. The Committee drew up a person specification for the role, taking into account the skills and experience required, the Code and the Articles of Association of the Company. The Zygos Partnership, signatories to the Voluntary Code of Conduct for Executive Search Firms, were engaged to identify candidates against this specification from FTSE 350 companies, large UK private companies, international companies and consultants' databases and networks. In parallel with this, an advertisement was placed in the Sunday Times.

Candidates from a wide range of relevant industry sectors and from both recruitment methods were identified and interviewed by the Committee. Having fully tested the market and assessed all candidates against the role requirements, the Committee agreed to recommend to the Board the appointment of Richard Parry-Jones as Chairman.

Upon selection by the Board, the Members were given the opportunity to meet Richard. Following this informal meeting, the Board appointed Richard Parry-Jones as a Non-Executive Director and Chairman Designate. Richard will be presented to Members for election at the Company's AGM in July 2012. Subject to Members' approval Richard will become Chairman after the AGM.

Richard Parry-Jones is currently completing his induction programme. Page 29 details the Network Rail Induction Programme.

#### Selection of new Directors

The Committee is committed to progressive refreshing of the Board. The starting point for any search is an analysis of the skills and experience required in the boardroom. Search consultants are then engaged to assist the Committee in this work.

#### Diversity and inclusion

The Committee considered Lord Davies' report, Women on Boards, and the Company's approach to Board diversity.

#### Steve Russell

Chairman  
Nomination and  
Corporate Governance Committee

## Policy and Performance Committee Report



**Bridget Rosewell**  
Chairman, Policy and Performance Committee

### Who is on the Committee?

Current members	From
Bridget Rosewell (Chairman)	January 2011
Rick Haythornthwaite	January 2010
Graham Eccles	March 2010
Lawrie Haynes	March 2010
Keith Ludeman*	July 2011
Steve Russell	January 2010

\*Appointed as a Non-Executive Director in July 2011

### Who attends meetings of the Committee?

The Chief Executive and Group Strategy Director, and occasionally other Executive Directors, attend by invitation.

### How many meetings were held during the year?

The Policy and Performance Committee met six times during the year.

### What is the role of the Committee?

The Committee's role is to monitor the quality, scope and integrity of the long and short-term planning and to monitor operational and project performance of the Company. The Committee reviews policy development and the relationships with stakeholders. It monitors the status of stakeholder goodwill and the Company's approach to stakeholder relationships, with particular emphasis on the Company's customers and their customers. The Committee will also investigate or advise on the above or any related matters that are referred to it, or as may appear to it to be necessary.

### What were the principal activities of the Committee during the year?

The Committee's activities in 2011/12 included (but were not exclusive to):

- scrutinising updates on current performance, challenging the response to the ORR finding Network Rail in breach of its licence and the outline projections for the balance of CP4. The issues raised in the ORR enforcement orders, and in particular actions in relation to performance for Freight, Scotland, London and South East and Long Distance, were addressed including the revised joint performance improvement plans
- scrutinising updates on the progress against CP4 delivery plan, compliance with other regulatory obligations and reform of the industry regulatory and contractual framework
- scrutinising reports on progress against the key periodic review 2013 milestones and development of CP5, including:
  - ORR consultation on the objectives for PR13 and the key regulatory framework issues
  - publication by Network Rail and its industry partners on the initial strategic business plans
  - publication by the ORR of advice to ministers and the framework for setting outputs and access charges
- scrutinising the proposals and processes to implement the key change programmes within the business including devolution (decentralising operations to routes), alliances (developing alliances with train operating companies), Project Dime (involving suppliers earlier in the delivery of projects and developing more collaborative working arrangements with suppliers; beginning the process of making the infrastructure projects division more of a separate business open to outside competition).
- reviewing the arrangements and risks associated with the opening of the National Centre at Milton Keynes
- reviewing the results of the following surveys – customers, enhancement funders and supplier perceptions.

**Bridget Rosewell**  
Chairman  
Policy and Performance Committee

## Treasury Committee Report



**Mike Firth**  
Chairman, Treasury Committee

### *Who is on the Committee?*

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

### *Who attends meetings of the Committee?*

The Group Finance Director, Group Treasurer and Head of Treasury Operations attend meetings by invitation.

### *How many meetings were held during the year?*

The Treasury Committee met three times during the year.

### *What is the role of the Committee?*

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.

### *What were the principal activities of the Committee during the year?*

The Committee considers on a routine basis:

- the treasury risk register
- debt issuance and investments
- interest rate hedging
- review and approval of the Group's Treasury Policy.

During the year, the Committee also focused on the following agenda items:

- investor relations and analysis, increasing activity so as to broaden the investor pool
- risk and impact of UK sovereign downgrade in relation to debt issuance
- Network Rail Insurance Limited and its investment strategy
- the Company's index-linked hedging portfolio and index-linked issuance strategy.

The Committee has been mindful of the current volatility in the financial markets and has sought assurance from the executive team on the Company's pro-activeness and responsiveness to the markets and credit rating agencies.

**Mike Firth**  
Chairman  
Treasury Committee

## Engaging with Members

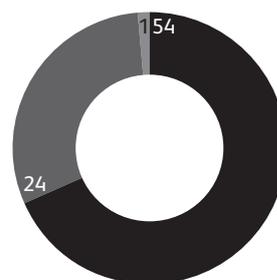
### Who are the Members?

Network Rail Limited as a company limited by guarantee, has Members, instead of shareholders. The Board is accountable to the Members. Members have the same rights and powers as shareholders though they do not have any financial interest in the Company.

Of the 79 current Members, there are two principal classes – Industry and Public Members. Industry Members have a right of automatic membership if they meet the eligibility criteria set out in the Articles of Association. An independent panel, the Membership Selection Panel, has responsibility for conducting the recruitment and selection process for Public Members.

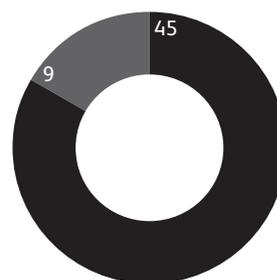
### Composition of Members as at 31 March 2012

Public Members	■
Industry Members	■
Department for Transport	■



### Split of male to female Public Members as at 31 March 2012

Male	■
Female	■



### What impact will the recently announced governance changes have on the composition of the membership?

Network Rail has recently announced proposed changes to the membership including the reduction in the number of Members from 79 to circa 40, which will be subject to confirmation by Members at the AGM in July 2012. The reduction will be largely achieved by the removal of industry membership.

***What is the role of Members?***

Members perform a similar role to shareholders in a public limited company. Members review the performance of Network Rail against industry benchmarks. Members do not make any strategic decisions themselves but hold the Board to account for the management of Network Rail. In particular they seek assurance from the Board that necessary processes are in place and being implemented to maintain high standards of corporate governance.

***How are new Members introduced to Network Rail?***

A workshop is held for new Members to understand more about the Group and its businesses. Topics covered in the workshop include:

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

Extensive resource material is available for new Members to familiarise themselves with Network Rail and the rail industry. This material is provided through the Members' dedicated website.

***How does Network Rail engage with Members?***

The Board considers that the transparency of its business is important, and encourages Members to actively participate in discussion relating to governance and performance.

In addition, to meeting the Board at formal meetings of the Company (AGM and, if needed, other General Meetings), the following were arranged for Members during the year:

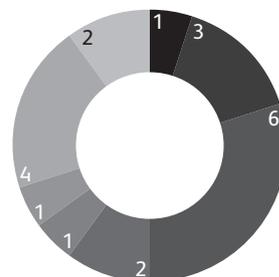
- half-yearly Members' meeting with the Chairman, Senior Independent Director and other Directors to consider half-year results
- Chief Executive briefings after full and half-year results, allowing Members to probe performance issues
- regular Members' meetings which included scrutiny sessions where Members were able to question Non-Executive Directors
- an introductory meeting with the new Chairman and a briefing from Justine Greening, the Secretary of State for Transport
- a meeting with the ORR to discuss the regulator's view on the Company's performance
- site visits to Reading Improvement Works and Liverpool Street Station
- conference calls to consult with Members as necessary.

Moreover, in addition to publishing full Annual Report and financial statements and half-year results, Network Rail also:

- provides a quarterly report from the Chairman of Network Rail on the Board's work over the preceding three months
- provides administrative support to Members in carrying out their role and dedicated research support
- provides Board and committee meetings agendas and minutes
- provides access to key documents such as Company business plans and ORR documents
- provides key contact details within Network Rail.

*Allocation of scheduled Members' events during 2011/12*

AGM	■
Briefings	■
Conference calls	■
Discussions with the Chief Executive	■
Half-year meeting	■
Meeting with the Office of Rail Regulation	■
Members workshop	■
Site visits	■



*What happens at the AGM?*

Each year, the Company holds an AGM. The next AGM will be held on 19 July 2012. Prior to the formal business of the AGM, presentations on topical matters and discussions are held. Members are able to ask questions on the day and also submit written questions in advance. Attendance at the AGM has been high for each year since its creation.

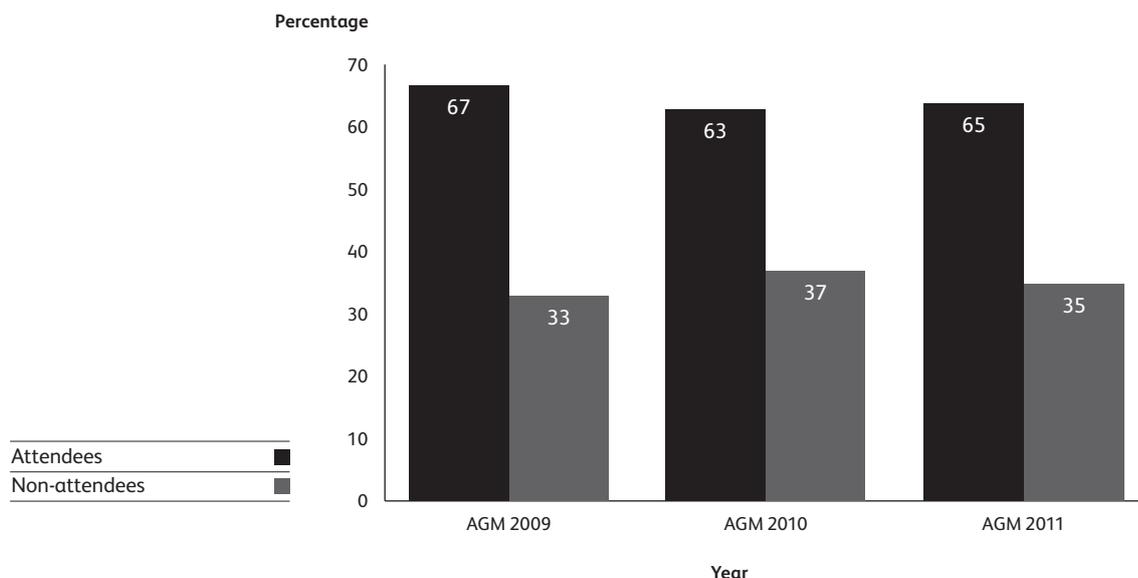
All Directors are encouraged to attend the AGM and all attended the 2011 AGM. The Board committee chairmen are available to answer questions in relation to their committee's area of responsibility. Directors are also available to engage with Members before and

after the AGM. The formal business of the AGM is separated out into single separate resolutions. Members have requisitioned resolutions at the majority of the AGMs since 2004 on a range of topics relating to operational performance and reporting, Members' governance arrangements and incentive awards.

Poll voting is adopted for all resolutions. The level of proxy votes received for the AGM is disclosed together with details of the votes for, against and the abstentions for each resolution.

The Notice of the AGM and any related papers are sent out to Members with the aim of arriving at least 20 business days before the date of the meeting.

*Members' attendance at meetings at AGMs over a three-year period*



# Directors' remuneration report

## Contents

### Page number

46 Remuneration Committee Chairman's letter

### Unaudited information

#### The Remuneration Committee

48 Committee membership  
48 Committee attendees  
48 Committee advisors  
48 Number of meetings held during the year  
48 Role of the Committee

#### Remuneration policy

48 Overall remuneration policy  
48 Network licence requirements

#### Key issues

49 Key issues considered during the year  
49 Executive Directors – attract and retain

#### Executive Directors' remuneration – fixed pay

49 Salaries  
50 Pay across the Group  
50 Additional benefits

#### Executive Directors' remuneration – variable pay

50 Structure of variable remuneration  
50 Annual incentives  
51 Outstanding long-term incentives  
52 Future long-term incentives  
52 Other long-term incentives

#### Executive Directors – details of appointment

52 Service agreements and notice periods  
52 Termination payments  
53 External appointments

#### Non-Executive Directors

53 Appointment terms and notice periods  
54 Fee structure  
54 External appointments

#### Audited information

55 Total Director remuneration  
56 Executive Director pension benefits  
58 Performance graph  
58 Directors' interests



### *The retention of our executive team is a key concern for the Committee.*

2012 has been a challenging year for the Remuneration Committee. In 2011, the Committee conducted a thorough review of executive compensation and incentives in the Company consulting widely with its key stakeholders including its Members and regulator (the Office of Rail Regulation). The key conclusions from this review were set out in the 2011 Annual Report. Following the completion of this consultation process, a general meeting was called for the Members of Network Rail to approve the long-term incentive plan – the Gainshare Plan – in February 2012. Following considerable media and political attention on executive remuneration and specifically our proposals, this meeting was adjourned, with the Gainshare Plan not having been approved, to allow the Committee to reflect further on how to incentivise performance of the Executive Directors against the backdrop of the current context and consult further with its stakeholders on this matter. In this context, the Executive Directors also decided to waive their entitlement to any award that might be earned from the 2011/12 annual incentive plan.

The scale of the challenge faced by Network Rail is considerable. It is a business of substantial scale and complexity. The drive for major improvements in capacity and quality of delivery is matched by other big changes designed to create much improved efficiency and responsiveness. The enhancements programme through to the end of Control Period 4 (CP4) (2009/10 – 2013/14) contains many programmes of a major scale, such as redevelopment of Reading (£895m), Blackfriars (£607m), Farringdon (£243m), Birmingham Gateway (£513m) and King's Cross (£548m) stations.

In operational terms, London Victoria, Liverpool Street, Waterloo and Euston stations each handle more passengers daily than the whole of Heathrow Airport. Network Rail is similar in many respects to National Grid, or to the combined UK water utility companies, and it is larger than BAA. It has significant risks associated with its day to day operations with the movement of three million people being safety critical.

The scale of the enhancement programme and the associated risk which Network Rail must manage is also bigger than that of many UK construction companies. There are high profile reputational risks associated with both operational and project failures.

To meet this scale of challenge we need outstanding leadership talent. The executive compensation needs to attract and retain that top talent as well as incentivise outperformance of the challenges in the CP4 Determination and the other essential change programmes designed to enable delivery of the significant improvements in efficiency required in Control Period 5 (CP5) (2014/15 – 2018/19).

The retention of our executive team is a key concern for the Committee (the risk that a number of key players could leave the Company is real). We have already had to take steps to deal with multiple poaching attempts that have offered remuneration packages well in excess of our current offers. Further, our inability to recruit targeted individuals offers specific evidence that we are significantly uncompetitive in some markets for key talent. That said, the Committee is mindful of the importance of balancing these market pressures with the need to deliver value for money to our funders and play its part in dealing with societal concerns about compensation disparity issues in a measured, responsible manner.

Over the last few months, the Committee and the Board have spent a considerable time determining a way forward for our Executive Directors which recognises, without being able to completely satisfy, these competing concerns, a solution that will require patience and some measure of compromise from all stakeholders in this difficult matter.

We will do the following:

1. Propose a 2012/13 Annual Incentive Plan that underpins the principal performance measures in our CP4 delivery plan with an on-target award reduced from 50 per cent to 30 per cent of basic salary and the maximum from 100 per cent to 60 per cent.
2. Drop the concept of the Gainshare Plan for CP4. Instead, long-term incentives for the remainder of CP4 will consist of three elements:
  - awards granted under the earlier 2009/12 LTIP, which had previously been approved by Members, were to have been rolled into the Gainshare Plan. As the Gainshare Plan has been dropped, the 2009/12 LTIP awards remain 'live' in their original form. A determination of the extent of payment under these awards will be undertaken by the Committee later in the year along with the timescale for any resulting payments pending determination by the ORR of the Financial Value Added and further consideration of discretion. The maximum possible award would remain 100 per cent of basic salary as at 1 April 2009.
  - a long-term plan will be developed to reward outperformance for the remainder of CP4 and the first year of CP5 (2012 to 2015). This plan will be subject to prior Member approval at a later date.
  - targeted one-off payments will be made to three of the Executive Directors subject to their continued employment until the end of CP4 and performance consistent with their seniority, role and objectives. These payments reflect retention risk outlined above.

We are of the view that the above steps, which are likely to amount in a significant reduction in the potential value of the variable pay for the Directors across CP4 relative to their previous packages and the Gainshare Plan Proposal, represent the minimum required to support the stated principles of performance-based remuneration, retain a focus on broad delivery of key CP4 outputs, maintain pressure on the very extensive array of change programmes and, above all, reduce the risk of loss of our leadership talent to tolerable levels.

### Unaudited information

The following report has been prepared in accordance with the Directors' Remuneration Report Regulations 2008, UK Corporate Governance Code and the Companies Act 2006.

### Who is on the Committee?

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

### Who attends meetings of the Committee?

The General Counsel is the secretary to the Committee.

The Director, Human Resources attends the meetings by invitation to assist the Committee in its considerations of market practice and the alignment of incentive arrangements to business strategy. The Chief Executive is also invited to attend certain parts of some Committee meetings (other than when his own remuneration is being discussed or decided) to assist the Committee in its consideration of the Company's performance and key operational objectives.

### Who advises the Committee?

During the year, New Bridge Street provided advice in connection with executive remuneration arrangements.

### How many meetings were held during the year?

The Committee met 12 times during the year.

### What is the role of the Committee?

The Committee determines remuneration for the Executive Directors. This provides independence of the decision-making process and reflects the importance of remuneration and incentive schemes in supporting the delivery of the Company's responsibilities.

The Committee determines all matters concerning incentives and remuneration of the Executive Directors of the Company. These include:

- making decisions in respect of the framework of the Executive Directors' remuneration and its cost
- determining, on behalf of the Board, specific remuneration packages for each of the Executive Directors

- deciding the remuneration package for the Chairman without the Chairman being present
- deciding upon the form and content of the management incentive plan (MIP) for each financial year
- determining the framework of certain senior executive employees' remuneration as well as the form and content of their incentive plans.

### What is the overall remuneration policy?

The Committee is very mindful of the need to give value for money to funders, and its overall policy is to attract and retain the high calibre executives that Network Rail needs to deliver stretching targets beyond those targets set by the ORR, not least in relation to efficiency.

The Committee has identified the key remuneration principles by which it must conduct its responsibilities as being:

- the need for the overall remuneration packages to represent 'value for money' particularly given both the current economic situation and the company's dependence on tax-payers
- the need to attract and retain the talent that Network Rail needs to deliver a safe and cost efficient railway that is capable of effectively responding to the increased expectations of both its customers and wider industry stakeholders including government
- the need to incentivise delivery of the outputs specified in the settlement for CP4, not least in relation to efficiency
- the need to reward results achieved through management effort and enterprise and sustainable – rather than transitory – delivery of efficiency improvements on the network to the benefit of both users and taxpayers.

These principles formed the basis for the review carried out by the Committee of the remuneration of senior management during the year.

### Are there any requirements under the network licence relating to remuneration?

Under its network licence, Network Rail is required to have appropriate performance-related pay schemes in place and when formulating its MIP, to have particular regard to:

- securing the safe operation and maintenance, renewal and replacement, improvement, enhancement and development of the network especially operational performance, asset serviceability and condition, efficiency and economy

- infringement by Network Rail of any access contracts and safety factors
- compliance with Network Rail's Code of Practice for dealings with dependent persons
- the extent to which Network Rail is subject to orders and to statements by the ORR on non-compliance with the licence.

### ***What key issues did the Committee consider during the year?***

In 2011/12 the Committee carried out amongst other items the following:

#### ***Remuneration review***

- set the basis for the Committee's review of executive remuneration
- determined the appropriate market comparator group against which to assess the competitiveness of the total reward package for senior executives
- reviewed actual pay and bonus levels received against comparator group actuals
- considered relevant corporate governance trends and developments in the UK and European Union
- consulted with Members in respect of proposed changes to the remuneration structure and individual packages.

#### ***Directors' remuneration***

- set annual bonus opportunity for each of the Executive Directors
- approved remuneration packages for each of the Executive Directors
- reviewed prior year performance and agreed bonus amounts payable for senior managers
- considered the terms of agreement for a departing Executive Director.

#### ***Annual and long-term incentive plans***

- set financial and non-financial targets and objectives for the annual incentive applicable to Executive Directors
- tested the satisfaction of performance conditions applicable to awards granted under the long-term incentive plan
- sought necessary approval at a general meeting for the introduction of a new Gainshare Plan.

#### ***Remuneration reporting and governance***

- reviewed and approved the Directors' Remuneration Report contained in the 2010/11 Annual Report
- periodically reviewed the Committee's Terms of Reference and the output of the annual review of Board effectiveness.

### ***How does the Committee assess the competitiveness of the Executive Directors' pay?***

Network Rail needs to ensure that it can attract and retain executives with the skills and experience necessary to manage a substantial and complex business. To achieve this, the Committee has a responsibility to ensure that the Executive Directors' pay arrangements are market competitive, albeit appropriately moderated to reflect Network Rail's receipt of public funds.

The Committee periodically commissions independent market reviews. The most recent review, carried out during 2011, contained a mixture of public sector and private sector data reference points. The main comparator group (below) contained a mixture of regulated and unregulated companies operating in broadly comparable business types or with broadly comparable business drivers, and which past experience suggests represent the most relevant markets for our talent:

*AMEC, Atkins, Balfour Beatty, Bunzl, Capita, Carillion, Invensys, Serco, Centrica, International Power, National Grid, Northumbrian Water, Pennon Group, SSE, Severn Trent, United Utilities, FirstGroup, Go-Ahead Group, National Express Group, Stagecoach Group.*

The 2011 review indicated that the fixed element of the executive directors' pay (salary, pension and benefits) was broadly lower quartile compared to this group and their total pay potential was significantly below the lower quartile. The Committee has concerns as to the sustainability of this market positioning in the medium-term if it is simultaneously being tasked with attracting and retaining an experienced management team. However, the Committee recognises the sensitivity of this issue for various stakeholders.

### ***What salaries do the Executive Directors receive?***

Salary levels are reviewed annually and set with reference to the relevant marketplace and incorporate an assessment by the Committee of the responsibilities, experience and performance of the individual.

Executive Directors received no salary increase in either 2009/10 or 2010/11. There were no adjustments in 2011/12 for David Higgins (who was appointed as a Director in February 2011) nor for Peter Henderson. The other Directors received an increase for 2011/12 of approximately 9 per cent to compensate in part for their increased responsibilities.

The Committee intends to adopt a policy whereby future salary increases for the Executive Directors are linked to the average managerial salary increase.

## Directors' remuneration report

### Annual basic salary as at 31 March 2012

	£
David Higgins	560,000
Patrick Butcher	382,000
Robin Gisby	360,000
Peter Henderson	440,000
Simon Kirby	360,000
Paul Plummer	338,000

### Does the Committee consider pay conditions for all employees within the Group when agreeing arrangements for Executive Directors?

In determining the remuneration arrangements for Executive Directors, the Committee is sensitive to pay and employment conditions elsewhere in the Group particularly when determining base salaries and reviews the proposed pay award for the Executive Directors against those for the general workforce.

In 2011/12 the front line workforce basic salary increased on average by 5.7 per cent (2010/11: 5.2 per cent). In 2011/12, the managerial salaries increased by 2.75 per cent (2010/11: 2.5 per cent). The Executive Directors' salaries increased on average by 5 per cent in 2011/12 (2010/11: nil).

### What additional benefits do the Executive Directors receive?

Executive Directors are entitled to a cash car allowance, private medical insurance, pension provision, discounted rail travel, life assurance and bi-annual health assessment.

### How is executive variable remuneration structured?

The structure of incentives for the Executive Directors comprise of two elements:

- annual incentive plan
- long-term incentive plan.

### What annual incentives do the Executive Directors receive?

Each year the Committee sets performance targets and potential awards for the Executive Directors under the annual incentive plan (AIP). Annually, at its meeting in May, the Committee reviews the level of achievement against the performance targets set and based on the Committee's judgement approves the award for each Director.

The Executive Directors waived their entitlement under AIP for 2011/12 and therefore no award will be made under the AIP in respect of 2011/12.

Payments made under the AIP are only earned by delivering specified outcomes. For the proposed 2012/13 AIP the outcomes are designed to incentivise not only the achievement of CP4 targets but also the successful delivery of key business change programmes.

The maximum bonus that can be achieved by Executive Directors under the AIP is 60 per cent of salary in 2012/13 (with a target of 30 per cent of salary), which represents a 40 per cent reduction on the maximum in the 2010/11 AIP.

The performance measures of the Executive Directors' AIP are still to be agreed with the ORR. However, it is proposed that the structure and metrics be broadly consistent with the corporate elements of the bonus scheme available to managers within the Group.

The details of the bonus structure applying to those managers are:

Performance measures	% of maximum bonus payout
<b>Passenger performance metric</b> which measures the percentage of trains arriving on time	27 %
<b>Freight performance metric</b> which measures the percentage of freight arriving on time	3 %
<b>Asset stewardship indicator</b> which measures the quality of Network Rail's asset stewardship based on asset condition, reliability and performance across Network Rail's key asset categories	20 %
<b>Cost efficiency</b> Annual cost of Network Rail, normalised by capacity provided and adjusted by renewals activity and compared to base year	20 %
<b>Passenger satisfaction</b>	10 %
<b>Customer satisfaction</b>	10 %
<b>Progress on Infrastructure Projects</b>	10 %

The performance measures are set in accordance with the targets in the two year joint performance improvement plans. Approximately 50 per cent of the maximum bonus is payable upon the achievement of targets. Performance must substantially exceed target in order for the maximum bonus to be payable.

For the Executive Directors, in assessing Network Rail's performance against each agreed measure, the Committee will take account of the ORR's annual assessment of Network Rail's performance. It will also receive reports from the Audit and Risk and Safety, Health and Environment Committees of the Board on performance during the year. The Internal Audit function will also provide verification of the level of achievement of the targets. The Committee will also take into account the conclusions of the Members scrutiny panel on the quality, appropriateness and

interpretation of the underlying data used by the Committee to calculate bonus levels and exercise its discretion. The Committee will publish the reasons for its decisions.

The Committee is able to adjust potential bonus payments (both upwards and downwards). Safety is a discretion overrider to the total payout (up or down) with positive targets to reduce enforcement notices and orders, early risk identification and culture change.

### *How are the outstanding long-term incentives structured?*

At the Company's Limited's Annual General Meeting (AGM) in July 2009, a long-term incentive plan was adopted by Members which covered the three year period running from 2009/10 to 2011/12 (2009 to 2012 LTIP). The performance focus of the LTIP is principally on Financial Value Added (FVA) which is defined as the value added in the relevant three-year period, over and above the amount set as an objective by the ORR for the relevant period in the CP4 Determination.

It was originally envisaged that the payments that would have been due in 2012 under the 2009 LTIP would be rolled into the Gainshare Plan. As the Gainshare Plan is not in operation, these 2009 LTIP awards cannot be rolled-into that plan and they are, therefore, due to be assessed later in the year.

The formula for FVA is the differences between the ORR's income and expenditure determinations and Network Rail's actual income and expenditure. FVA is expressed in £m. Thus, if Network Rail outperforms the ORR determinations by £100m over the relevant three-year period, the FVA Index is expressed as +£100m. The FVA target for maximum payment under this award was +£300m over the period 2009/10 to 2011/12.

The Committee will determine performance against this FVA target later in the year pending review by the ORR. At the same time it will consider whether there should be any downward adjustment to any resulting payments to reflect overall business performance over this three-year period.

The Committee will also take into account all factors that it believes are appropriate for assessing overall business performance over the three-year period including:

- safety performance (passenger and workforce)
- the extent to which the key objectives of the Delivery Plan over the performance period have been achieved
- financial performance, including the level of Net Debt and other relevant ratios
- reputational issues
- compliance with the obligations set out within the network licence
- compliance with the conditions as set out in the Access Agreements with our customers
- any breaches of contract or other significant issues
- any other objectives that ORR may specify from time to time
- the conclusions of the Members scrutiny panel on the quality, appropriateness and interpretation of data used by the Committee to exercise its discretion.

The Committee's determination in relation to the above will be fully set out in the 2012/13, Directors' remuneration report.

### *Maximum potential LTIP awards*

	Performance period			
	1 April 2009 to 31 March 2012***	1 April 2010 to 31 March 2013	1 April 2011 to 31 March 2014	1 April 2012 to 31 March 2015****
David Higgins*	Nil	Nil	Nil	TBC
Patrick Butcher**	350,000	Nil	Nil	TBC
Robin Gisby	330,000	Nil	Nil	TBC
Peter Henderson	440,000	Nil	Nil	TBC
Simon Kirby	330,000	Nil	Nil	TBC
Paul Plummer	310,000	Nil	Nil	TBC
Total	1,760,000	Nil	Nil	TBC

\* Appointed to the Board of Directors as Executive Director on 1 February 2011; previously a Non-Executive Director from 1 April 2010 to 31 January 2011.

\*\* Appointed to the Board of Directors on 20 April 2009.

\*\*\* The maximum payment for the performance period 1 April 2009 to 31 March 2012 plan is equal to 100 per cent of basic salary as at 1 April 2009.

\*\*\*\* A long-term plan will be developed to reward outperformance for the remainder of CP4 and the first year of CP5 (2015 – 2019).

### **How will future long-term incentives be structured?**

The Committee intends to introduce a long-term award for the Executive Directors for the three-year performance period 2012/13 to 2014/15. As part of the design process, the Committee will be consulting with various stakeholders to obtain input into the principles and structure that should underlie this award. Members' approval will be sought for the finalised award structure.

### **What other long-term awards can the Executive Directors receive?**

As noted elsewhere in this Report, the Committee has significant concerns about the risk of losing key executives at the current time. To offset this risk, it has agreed that one-off awards of £300,000 each should be payable to three of the Executive Directors (Robin Gisby, Patrick Butcher and Simon Kirby) in April 2014. These payments reflect retention risk outlined above and the increased responsibilities of these particular Directors.

The past year has seen a significant restructuring of Network Rail – with a focus on closer co-operation with customers to deliver greater efficiencies and better performance. As a result a number of Executive Directors have seen a considerable increase in their accountabilities and responsibilities as follows:

- a significant part of Peter Henderson's portfolio was reassigned to Robin Gisby upon completion of the devolution programme on 14 November. This represents almost a trebling of Robin's headcount responsibility, from 8,200 to 24,100 and a 391 per cent increase in budget responsibility
- Patrick Butcher took over responsibility for a range of different business and professional services from a number of different Directors across the business. His expanded portfolio represents a 250 per cent increase in headcount and a 270 per cent increase in budget responsibility
- Simon Kirby was tasked with delivering the most significant investment programme for decades – including a doubling of annual investment from 2009 to 2014. He is also responsible for creating a new rail projects business within Network Rail to provide a benchmark for Network Rail services against external competition. This £3bn per annum business will be a similar size to one of the country's top five construction firms.

These payments are conditional on the Directors being in employment of the Company at the time of payment, certain performance conditions and will be subject to prior Member approval.

The performance conditions require the Directors to be rated within the established performance management and appraisal system at levels of 'Good', 'Exceeded' or

'Outstanding' in each year of the retention period against targets that are established by the Chief Executive. The Committee will reassure itself of the appropriateness and overall degree of challenge of the performance framework.

### **What are the terms of the Executive Directors' service agreements?**

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

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

#### **Current service agreements:**

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

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

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

### **How are the Executive Directors compensated in the event of the termination of their contract?**

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 Department for Transport (in its role as provider of credit facilities) decide that these appointments should not be terminated.

Taking into account 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 agreement contains an express provision requiring the departing Executive 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.

### **What is the Group's policy on Executive Directors holding external appointments?**

The Group is supportive of Executive Directors who wish to take on a non-executive directorship in order to broaden their experience and enhance their contribution to the Company. Executive Directors are normally required to seek approval from the Committee to retain any fees they receive in respect of such appointments.

David Higgins is currently a Non-Executive Director of Sirius Minerals plc and received fees of £845 for the role during the year. David Higgins and Peter Henderson are Non-Executive Directors of Rail Safety and Standards Board Limited. Patrick Butcher is a member of the British Transport Police Authority. No fees are received by them for these positions.

### **Non-Executive Directors What are the appointment terms and notice periods for Non-Executive Directors?**

The Non-Executive Directors of the Company are also the Directors of Network Rail Infrastructure Limited and their letters of appointment are with that company. The terms of their engagement are set out in a letter of appointment. No other contractual provisions or remuneration arrangements exist in relation to their directorships (if any) of any other company within the Network Rail Group.

#### **Current letters of appointment:**

	Effective date of original letter of appointment
Malcolm Brinded	12 October 2010
Graham Eccles	7 February 2010
Mike Firth	4 December 2004
Lawrie Haynes	26 January 2010
Rick Haythornthwaite	23 March 2009
Janis Kong	13 January 2010
Keith Ludeman	5 July 2011
Richard Parry-Jones	28 March 2012
Bridget Rosewell	18 January 2011
Steve Russell	19 September 2007

#### **Non-Executive Directors' contractual terms of appointment:**

Provision	Policy
<b>Period of appointment</b>	Three year term which can be extended by mutual consent
<b>Termination without compensation</b>	By the Director or the Company giving the other six months' written notice
<b>Fees</b>	As described on page 54
<b>Expenses</b>	Reimbursement of expenses reasonably and properly incurred in attending meetings of the Board or otherwise in the performance and discharge of their duties and responsibilities
<b>Time commitment</b>	Varying dependent on Board and Board committee duties but in general terms estimated to comprise as a minimum per annum*: <ul style="list-style-type: none"> <li>• eight Board meetings (three of which will be off-site in 2011/12)**</li> <li>• typically six or more Board Committee meetings (depends on committee membership)**</li> <li>• three Stakeholder relationship events</li> <li>• one Board strategy day**</li> <li>• one AGM**</li> <li>• two Members' workshops/meetings**</li> <li>• three Non-Executive Directors only meetings.</li> </ul>

\* Excluding induction phase.

\*\* Each of these are anticipated to require preparation time of up to one day per meeting.

### What is the policy on Non-Executive Directors' fees?

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

Non-Executive Directors' fees is broadly to reflect the relevant market median.

The fees were last reviewed in January 2011 and no increase in base fees or committee chair fees were awarded.

Non-Executive Directors do not receive any benefits from the Company or from the Network Rail Group nor participate in any incentive scheme or pension arrangements. Graham Eccles receives a pension from the industry-wide Railway Pensions Scheme but this pension is not associated with Network Rail rather from his previous employment within the rail industry.

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

	Board membership	Senior Independent Director	Committee chairmanship*			
			Safety Health and Environment	Remuneration	Policy and Performance	Audit and Risk
Malcolm Brinded	50,000					
Graham Eccles	50,000					
Mike Firth	50,000				10,000	6,000
Lawrie Haynes	50,000		10,000			
Rick Haythornthwaite	250,000					
Janis Kong	50,000					
Keith Ludeman	50,000					
Richard Parry-Jones**	50,000					
Bridget Rosewell	50,000				10,000	
Steve Russell	50,000	9,000		10,000		

\* In view of the additional responsibilities and time commitment placed upon the chairmen of Board committees and Senior Independent Director additional fees have been paid to Non-Executive Directors who chair certain of the Board committees.

\*\* On appointment as Chairman of the Board, Richard Parry-Jones will receive a fee of £250,000 per annum. The Committee commissioned an independent market review which indicated that the fee continued to be appropriate.

### What is the Group's policy on Non-Executive Directors holding external appointments?

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

## Audited information

### Disclosure of Directors' remuneration for 2011/12

This section of the report sets out the remuneration paid to the Directors in respect of the financial year to 31 March 2012.

#### Directors' remuneration comparison 2011/12 against 2010/11 (£000s)

	Basic salary/fees		Incentives*		Benefits		Pension allowance		Total		Supplementary Company pension contributions/AV payments by the Company	
	2011/12	2010/11	2011/12	2010/11	2011/12	2010/11	2011/12	2010/11	2011/12	2010/11	2011/12	2010/11
<b>Executive Directors</b>												
David Higgins <sup>A</sup>	560	132	–	–	15	2	8	–	583	134	153	27
Patrick Butcher	382	350	–	–	15	15	106	–	503	365	2	99
Robin Gisby	360	330	–	62	15	15	102	81	477	488	–	–
Peter Henderson	440	440	–	91	14	15	98	–	552	546	13	126
Simon Kirby	360	330	–	68	15	15	95	4	470	417	7	88
Paul Plummer	338	310	–	62	15	17	95	76	448	465	–	–
<b>Non-Executive Directors</b>												
Malcolm Brinded	50	23	–	–	–	–	–	–	50	23	–	–
Graham Eccles	50	50	–	–	–	–	–	–	50	50	–	–
Mike Firth	66	66	–	–	–	–	–	–	66	66	–	–
Lawrie Haynes	60	54	–	–	–	–	–	–	60	54	–	–
Rick Haythornthwaite	250	250	–	–	–	–	–	–	250	250	–	–
Janis Kong	50	50	–	–	–	–	–	–	50	50	–	–
Keith Ludeman <sup>B</sup>	37	–	–	–	–	–	–	–	37	–	–	–
Richard Parry-Jones <sup>C</sup>	1	–	–	–	–	–	–	–	1	–	–	–
Bridget Rosewell	60	12	–	–	–	–	–	–	60	12	–	–
Steve Russell	69	60	–	–	–	–	–	–	69	60	–	–
<b>Total emoluments of Directors</b>	<b>3,133</b>	<b>2,457</b>	<b>–</b>	<b>283</b>	<b>89</b>	<b>79</b>	<b>504</b>	<b>161</b>	<b>3,726</b>	<b>2,980</b>	<b>175</b>	<b>340</b>

A Joined the Board as Chief Executive on 1 February 2011, previously a Non-Executive Director from 1 April 2010 to 31 January 2011

B Joined the Board on 5 July 2011

C Joined the Board on 28 March 2012

\* In February 2012, the Executive Directors waived their entitlement to annual incentive awards for 2011/12. The 2010/11 figure relates to the value of a long-term incentive award that crystallised in 2011.

#### Notes

- 1 Benefits – all Executive Directors received life assurance benefits during such part of the year as they were employed by the Company that relate to the cost incurred by the Company of insuring the Directors' life assurance benefits which, had they died during the year, could not have been wholly paid by the relevant pension scheme and would therefore have been met by the insurance company. The disclosure also includes the cost of private medical insurance, car benefits and any travel subsidy. All the numbers disclosed include the tax charged on the benefits. No Director received an expense allowance during the year.
- 2 Pension allowance – these Executive Directors received supplementary Company pension contributions paid as a cash allowance instead of an additional pension contribution to the Network Rail Defined Contribution (NRDC) Scheme.
- 3 The total amount of Directors' emoluments for services provided solely to the Company during the year was £4m (including supplementary Company pension contributions) (2010/11: £4m).
- 4 The supplementary Company pension contributions/AVC payment by the Company reflect values for the full year.
- 5 Executive Directors receive salaries and Non-Executive Directors receive fees.

## **What pension benefits do the Executive Directors receive?**

### **Core pension benefits**

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

In normal circumstances the earliest age at which members are entitled to receive their defined benefit pension without actuarial reduction is age 60 in the RPS or age 65 in the CARE Scheme. However, the Directors can retire early on the same terms and conditions that apply to other members of the respective scheme from the age of 55 or in some cases age 50 in the RPS. In the CARE Scheme, Directors may retire early from age 55, the employer's consent is required and the pension is then subject to cost neutral early retirement terms. In the NRDC Scheme, Directors can retire early from age 55 on the same terms and conditions that apply to other NRDC members. As NRDC benefits are provided on a money purchase basis, actuarial reduction factors are not applicable.

The table on page 57 shows the accrued pension entitlement from the respective Network Rail pension scheme for each Executive Director of the Company during the year ended 31 March 2012, together with the increases in those benefits during the year, calculated using the accrued benefit basis.

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

The increase in accrued defined benefit during the year is shown in the table on page 57. Values are normally shown before (column A) and after (column B) the effect of inflation. All benefit values shown exclude any additional voluntary contributions made by the Director.

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

### **Additional pension benefits**

Directors entitled to additional pension allowance take this as a cash salary supplement subject to an adjustment for National Insurance Contributions; some Directors may choose to have the gross payment made to the NRDC Scheme as a pension contribution.

The contributions made during the year together, where appropriate, with contributions in respect of benefits accrued prior to the year under review are shown on page 58.

### Core pension benefits

	Gross increase in accrued occupational pension £ (A)	Increase in accrued occupational pension net of inflation £ (B)	Total accrued occupational pension at 31 March 2012 £ (C)	Transfer value of accrued occupational pension at 31 March 2011 £ (D)	Transfer value of accrued occupational pension at 31 March 2012 £ (E)	Total change in transfer value during period £ (F)	Value of net increase in accrual over period £ (G)
David Higgins	–	–	–	19,532	41,528	21,996	16,827
Patrick Butcher	2,492	2,258	6,682	32,518	78,864	17,343	37,043
Robin Gisby	3,583	2,059	32,903	408,999	532,794	19,922	110,382
Peter Henderson	3,008	2,100	20,482	278,281	380,863	25,630	89,168
Simon Kirby	2,935	2,105	18,907	134,029	170,664	5,585	23,222
Paul Plummer	3,234	2,084	25,358	182,990	225,639	5,126	29,236

#### Notes

- 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.
- As in prior years figures in (B) showing inflation adjusted values reflecting the year to 30 September. The inflation adjustment is based on the revaluation method in accordance with the Trust Deed and Rules of each pension scheme. The RPS is subject to increases based on September CPI and therefore a revaluation rate of 5.2 per cent was applied in respect of members of that Scheme. The CARE Scheme reflects revaluation based on September RPI and therefore a rate of 5.6 per cent was applied in respect of that Scheme member.
- Transfer values as at 31 March 2011 (D) and 31 March 2012 (E) have been calculated in accordance with 'The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008'.
- 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.
- 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.
- The NRDC Scheme member does not have an accrued pension as this only applies to defined benefit schemes and therefore only the employer pension contribution is shown (G) based on seven per cent of pensionable salary up to the notional earnings cap (£129,600 for all four weekly pay periods ending before 6 April 2012 and £137,400 for subsequent pay periods).
- The Company operates a SMART arrangement whereby, for participating employees, the employee member's normal contributions are paid by the Company and the employee member's pensionable pay is reduced accordingly. For the purposes of these disclosures any SMART contributions have been treated as employee member contributions on a notional basis.

## Directors' remuneration report

### Additional pension or benefits

	Company contributions to additional pension provision or alternative salary supplement whilst a Director during the year £	Company contributions to additional pension provision or alternative salary supplement during prior year £	Matching Company additional voluntary contributions whilst a Director during the year £
David Higgins <sup>D</sup>	160,860	26,763	–
Patrick Butcher <sup>*B</sup>	108,386	99,200	–
Robin Gisby <sup>*A</sup>	101,770	81,200	–
Peter Henderson <sup>*C</sup>	110,351	126,304	–
Simon Kirby <sup>E</sup>	101,770	92,487	–
Paul Plummer <sup>*A</sup>	95,154	75,951	4,844

A These Directors elected to receive an equivalent additional allowance in 2011/12 in lieu of additional pension contributions. This payment is included in the benefit figure.

B This Director elected to switch from additional pension contributions to an equivalent annual allowance with effect from 10 April 2012.

C This Director elected to switch from additional pension contributions to an equivalent annual allowance with effect from 8 May 2011.

D This Director elected to switch from additional pension contributions to an equivalent annual allowance with effect from 11 March 2012.

E This Director elected to switch £7,117 from annual allowance to additional pension contributions in pay period four effective from 5 June to 2 July 2011, reverting to an equivalent annual allowance with effect from pay period 5 effective from 3 July 2011.

#### Notes

1 None of the Non-Executive Directors are members of any Network Rail pension arrangement nor do they have other pension entitlements save that Graham Eccles receives a pension from the Railway Pension Scheme relating to his previous employment.

2 Where a Director is entitled to additional pension contributions they can choose the payment either as a pension contribution to the NRDC Scheme or a salary supplement, less an adjustment for National Insurance Contributions for some directors.

\* The salary supplement received by these directors was not subject to an adjustment for National Insurance Contributions. This policy was changed to allow a cash allowance only from 2011 for new Directors.

### 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.



Steve Russell  
Chairman, Remuneration Committee  
6 June 2012

## ***Other statutory information***

***Pages 1 to 61 (together with the sections of the annual report incorporated by reference) constitute the Directors' report and business review. The financial statements are presented on pages 64 to 100.***

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

### ***Principal activities***

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

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

### ***Profit***

The profit before tax was £475m (2010/11: profit of £442m) and the profit after tax was £761m (2010/11: profit of £320m). Further details of the financial results can be found in the financial statements commencing on page 64.

### ***Share capital***

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

### ***Research and development***

During the year the Company charged £2m to the Income statement (2010/11: £1m) on research and development. Other costs relating to significant development work have been capitalised in property, plant and equipment.

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

### ***Charitable donations***

During the year Network Rail donated £589,240 to charitable organisations (2010/11: £635,181) and leveraged a further £1,805,638 through gifts in kind, employee fundraising and other initiatives, totalling £2,394,878.

This year sees the end of Network Rail's successful two-year Charity of Choice partnership with Cancer Research UK. The aim of the partnership was to raise over £1m, and in fact the total raised was £2,103,049 thanks to a combination of donations from the Company, employee fundraising, matched giving and volunteering time, and gifts in kind.

Following an employee vote in early 2012 in which almost 40 per cent of employees participated, Network Rail's new Charity of Choice for 2012 to 2014 will be Action for Children.

Further details of charitable giving can be found in the Company's Sustainability Update which will be available at: [www.networkrail.co.uk](http://www.networkrail.co.uk) later in 2012.

## *Other statutory information*

### ***Political donations***

In line with Network Rail's policy, no donations to political parties were made in the year (2011; £nil).

The Companies Act 2006 (CA 2006) contains restrictions on companies making political donations and incurring political expenditure and it defines these terms very widely. This could extend to routine activities undertaken by Network Rail as part of its normal day-to-day business.

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

Accordingly, since it is vital that Network Rail communicates frequently with the full spectrum of political organisations, the Board annually seeks Members' approval at the Annual General Meeting (AGM) of Network Rail Limited to avoid inadvertently breaching the CA 2006.

### ***Supplier payment policy***

Network Rail's policy, with respect to payment of its suppliers, is to settle the terms of payment when agreeing the terms of each transaction where standard terms are not used, to make suppliers aware of the terms of payment and to abide by the terms of payment.

At 31 March 2012 the Company's creditor days compared with the value of suppliers' invoices received in the year were 41 days (2010/11: 49 days).

### ***Statement of Directors' responsibilities***

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the Group and parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently
- make judgements and accounting estimates that are reasonable and prudent
- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements comply with the CA 2006. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

### ***External auditors***

At the 2012 AGM, a resolution will be proposed to re-appoint PricewaterhouseCoopers LLP as the Group's auditors and to authorise the Directors to fix their remuneration. Details of the fees earned by PricewaterhouseCoopers LLP during the period, for both audit and non-audit work, are set out in Note 5 on page 74.

### ***Disclosure of information to auditors***

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

### ***Going concern***

The Directors are satisfied that the Network Rail Group has adequate resources to continue to operate for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the accounts. See Note 2 of the financial statements on pages 68 to 73.

### ***Annual General Meeting (AGM)***

The 2012 AGM of Network Rail Limited will be held on 19 July 2012 in Glasgow. A separate document accompanying the Annual Report and financial statements contains the Notice convening the meeting and a description of the business to be conducted at that meeting.

### ***Subsequent significant events***

There have been no significant balance sheet events subsequent to 31 March 2012 to the date of this report.

On behalf of the Board of Network Rail

**Suzanne Wise**  
General Counsel  
6 June 2012

# *Independent auditors' report*

## *to the Members of Network Rail Limited*

We have audited the Group and parent company financial statements (the 'financial statements') of Network Rail Limited for the year ended 31 March 2012 which comprise the Group Income statement, the Group Statement of comprehensive income, the Group and parent Company Balance sheets, the Group and parent Company Statements of cash flows, the Group Statement of changes in equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent Company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

### *Respective responsibilities of Directors and auditors*

As explained more fully in the Directors' responsibilities statement on page 60, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

### *Scope of the audit of the financial statements*

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

### *Opinion on financial statements*

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 March 2012 and of the Group's profit and Group's and parent Company's cash flows for the year then ended
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union
- the parent Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

### ***Opinion on other matter prescribed by the Companies Act 2006***

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

### ***Matters on which we are required to report by exception***

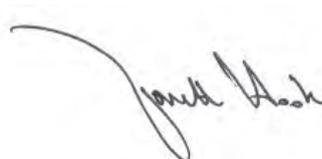
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

The Directors have requested, (because the Company applies Listing Rules 9.8.6R 3, 5 and 6 of the Financial Services Authority as if it were a listed company), that we review the parts of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review by the Listing Rules of the Financial Services Authority and that we review the Directors' statement, set out on page 61, in relation to going concern. We have nothing to report in respect of these reviews.

### ***Other matter***

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



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

London  
6 June 2012

# Income statement

for the year ended 31 March 2012

	Notes	Results pre debt and derivative revaluations 2012 Group £m	Debt and derivative revaluations (Note 8) 2012 Group £m	2012 Group £m	2011 Group £m
Revenue	3	6,004	–	6,004	5,712
Net operating costs	4	(3,657)	–	(3,657)	(3,674)
<b>Operating profit</b>		<b>2,347</b>	<b>–</b>	<b>2,347</b>	<b>2,038</b>
Property revaluation movements and profits on disposal		19	–	19	11
<b>Total profits from operations</b>	5	<b>2,366</b>	<b>–</b>	<b>2,366</b>	<b>2,049</b>
Investment revenue	7	45	–	45	77
Other gains and losses	8	–	(567)	(567)	(183)
Finance costs	9	(1,369)	–	(1,369)	(1,501)
<b>Profit before tax</b>		<b>1,042</b>	<b>(567)</b>	<b>475</b>	<b>442</b>
Tax	10	139	147	286	(122)
<b>Profit for the year</b>		<b>1,181</b>	<b>(420)</b>	<b>761</b>	<b>320</b>

Under section 408 of the Companies Act 2006 the Group has elected to take the exemption with regard to disclosing the Company Income statement. The Company's profit after tax for the year was £nil (2011: £nil).

# Statement of comprehensive income

for the year ended 31 March 2012

	Notes	2012 Group £m	2011 Group £m
<b>Profit for the year</b>		<b>761</b>	<b>320</b>
Gain on revaluation of the railway network	12	313	222
Losses on movement in fair value of hedging derivatives		(93)	(251)
Reclassification of balances in hedging reserve to the income statement		67	365
		(26)	114
Actuarial (losses)/gains on defined benefit pension schemes	28	(245)	545
Tax relating to components of other comprehensive income	22	29	(60)
<b>Other comprehensive income for the year</b>		<b>71</b>	<b>821</b>
<b>Total comprehensive income</b>		<b>832</b>	<b>1,141</b>

Under section 408 of the Companies Act 2006 the Group has elected to take the exemption with regard to disclosing the Company Statement of Comprehensive Income. The Company's total comprehensive income for the year was £nil (2011: £nil).

# Statement of changes in equity

for the year ended 31 March 2012

<i>Group</i>	Revaluation reserve £m	Other reserve* £m	Hedging reserve £m	Retained earnings £m	Total £m
<b>Balance at 1 April 2010</b>	<b>2,807</b>	<b>249</b>	<b>(334)</b>	<b>3,222</b>	<b>5,944</b>
Profit for the year	–	–	–	320	320
<b>Other comprehensive income</b>					
Impact of change in tax rate	103	–	(10)	(18)	75
Revaluation of the railway network	222	–	–	–	222
Transfer of deemed cost depreciation from revaluation reserve	(158)	–	–	158	–
Increase in deferred tax liability on the railway network	(17)	–	–	(41)	(58)
Actuarial gains on defined benefit pension schemes	–	–	–	545	545
Deferred tax on actuarial gains	–	–	–	(142)	(142)
Decrease in fair value of hedging derivatives	–	–	(251)	–	(251)
Deferred tax on all hedging reserve movements/retained earnings	–	–	65	–	65
Reclassification of balances in hedging reserve to the income statement	–	–	365	–	365
<b>Total comprehensive income</b>	<b>150</b>	<b>–</b>	<b>169</b>	<b>822</b>	<b>1,141</b>
<b>Balance at 31 March 2011</b>	<b>2,957</b>	<b>249</b>	<b>(165)</b>	<b>4,044</b>	<b>7,085</b>
Profit for the year	–	–	–	761	761
<b>Other comprehensive income</b>					
Impact of change in tax rate	107	–	(49)	(12)	46
Revaluation of the railway network	313	–	–	–	313
Transfer of deemed cost depreciation from revaluation reserve	(235)	–	–	235	–
Increase in deferred tax liability on the railway network	(19)	–	–	(56)	(75)
Actuarial losses on defined benefit pension schemes	–	–	–	(245)	(245)
Deferred tax on actuarial losses	–	–	–	59	59
Decrease in fair value of hedging derivatives	–	–	(93)	–	(93)
Deferred tax on all hedging reserve movements/retained earnings	–	–	(1)	–	(1)
Reclassification of balances in hedging reserve to the income statement	–	–	67	–	67
<b>Total comprehensive income</b>	<b>166</b>	<b>–</b>	<b>(76)</b>	<b>742</b>	<b>832</b>
<b>Balance at 31 March 2012</b>	<b>3,123</b>	<b>249</b>	<b>(241)</b>	<b>4,786</b>	<b>7,917</b>

\* Other reserves of £249m (2011: £249m) include the vesting reserve on privatisation.

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

# Balance sheets

at 31 March 2012

	Notes	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
<b>Assets</b>					
<b>Non-current assets</b>					
Intangible assets	11	70	71	-	-
Property, plant and equipment – the railway network	12	43,112	39,577	-	-
Investment property	13	878	778	-	-
Derivative financial instruments	20	672	576	-	-
Finance lease receivables	16	5	6	-	-
Interest in joint venture	14	6	5	-	-
<b>Total non-current financial assets</b>		<b>683</b>	<b>587</b>	<b>-</b>	<b>-</b>
		<b>44,743</b>	<b>41,013</b>	<b>-</b>	<b>-</b>
<b>Current assets</b>					
Inventories	15	125	108	-	-
Finance lease receivables	16	1	1	-	-
Trade and other receivables	17	672	910	-	-
Current tax assets		8	-	-	-
Derivative financial instruments	20	1	104	-	-
Cash and cash equivalents		1,886	771	-	-
		<b>2,693</b>	<b>1,894</b>	<b>-</b>	<b>-</b>
<b>Total assets</b>		<b>47,436</b>	<b>42,907</b>	<b>-</b>	<b>-</b>
<b>Current liabilities</b>					
Trade and other payables	18	(2,704)	(2,823)	-	-
Current tax liabilities		-	(3)	-	-
Borrowings	19	(1,157)	(2,317)	-	-
Derivative financial instruments	20	(411)	(373)	-	-
Provisions	21	(12)	(17)	-	-
Obligations under finance leases	23	(1)	(1)	-	-
		<b>(4,285)</b>	<b>(5,534)</b>	<b>-</b>	<b>-</b>
<b>Net current liabilities</b>		<b>(1,592)</b>	<b>(3,640)</b>	<b>-</b>	<b>-</b>
<b>Non-current liabilities</b>					
Borrowings	19	(27,929)	(23,349)	-	-
Derivative financial instruments	20	(797)	(574)	-	-
Other payables	18	(2,769)	(2,494)	-	-
Retirement benefit obligation	28	(661)	(485)	-	-
Deferred tax liabilities	22	(3,078)	(3,385)	-	-
Obligations under finance leases	23	-	(1)	-	-
		<b>(35,234)</b>	<b>(30,288)</b>	<b>-</b>	<b>-</b>
<b>Total liabilities</b>		<b>(39,519)</b>	<b>(35,822)</b>	<b>-</b>	<b>-</b>
<b>Net assets</b>		<b>7,917</b>	<b>7,085</b>	<b>-</b>	<b>-</b>
<b>Equity</b>					
Revaluation reserve		3,123	2,957	-	-
Other reserve		249	249	-	-
Hedging reserve		(241)	(165)	-	-
Retained earnings		4,786	4,044	-	-
<b>Total equity</b>		<b>7,917</b>	<b>7,085</b>	<b>-</b>	<b>-</b>

The financial statements on pages 64 to 100 were approved by the Board of Directors and authorised for issue on 6 June 2012.

They were signed on its behalf by:

**David Higgins** Director      **Patrick Butcher** Director

Company registration number: 4402220

# Statements of cash flows

for the year ended 31 March 2012

	Notes	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
<b>Net cash generated from operating activities</b>	24	<b>2,691</b>	2,486	-	-
<b>Investing activities</b>					
Interest received		40	77	-	-
Purchases of property, plant and equipment		(4,521)	(3,759)	-	-
Proceeds on disposal of property		29	12	-	-
Capital grants received		400	186	-	-
Capital element of finance lease receipts		1	2	-	-
<b>Net cash used in investing activities</b>		<b>(4,051)</b>	(3,482)	-	-
<b>Financing activities</b>					
Repayments of borrowings		(2,545)	(1,926)	-	-
Repayments of obligations under finance leases		(1)	-	-	-
New loans raised		5,489	1,782	-	-
Collateral repaid to counterparties		(78)	(395)	-	-
Cash flow on settlement of derivatives		(390)	(15)	-	-
<b>Net cash generated from/(used in) financing activities</b>		<b>2,475</b>	(554)	-	-
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>1,115</b>	(1,550)	-	-
Cash and cash equivalents at beginning of the year		771	2,321	-	-
<b>Cash and cash equivalents at end of the year</b>		<b>1,886</b>	771	-	-

# Notes to the financial statements

for the year ended 31 March 2012

## 1. General information

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

The Company registration number is 4402220.

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

The Company's principal activities are detailed in the Group strategic framework on page 13.

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

### *Presentation of the Income statement: exceptional debt and derivative revaluations*

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

## 2. Significant accounting policies

### *Basis of accounting*

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

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

The principal accounting policies adopted by the Directors are set out below. The policies have been consistently applied to the years presented.

### *Adoption of new and revised standards*

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

Revised IAS 24	<i>Related Party Disclosures</i>
IFRIC 19	<i>Extinguishing Financial Liabilities with Equity Instruments</i>
Amendments to IFRIC 14	<i>Prepayments of a Minimum Funding Requirement</i>
Improvements to IFRS 2010	

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

IFRS 9	<i>Financial Instruments</i>
IFRS 10	<i>Consolidated Financial Statements</i>
IFRS 11	<i>Joint Arrangements</i>
IFRS 12	<i>Disclosure of Interests in Other Entities</i>
IFRS 13	<i>Fair Value Measurement</i>
IAS 19 (revised)	<i>Employee Benefits</i>
IAS 27	<i>Separate Financial Statements</i>
IAS 28	<i>Investments in Associates and Joint Ventures</i>
Amendments to IAS 1	<i>Presentation of Financial Statements</i>
Amendments to IAS 12	<i>Income Taxes</i>
Amendments to IAS 32	<i>Financial Instruments: Presentation</i>
Amendments to IFRS 7	<i>Financial Instruments: Disclosures</i>

The Group has yet to assess the full impact of these accounting standards.

## **2. Significant accounting policies** continued

### **Going concern**

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Group strategic framework and strategic themes on pages 13 to 19. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Group Finance Director's review on pages 8 to 12. In addition, Note 27 to the accounts includes the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit, liquidity and foreign exchange risk.

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

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

### **Basis of consolidation**

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

### **Revenue recognition**

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

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

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

### **Grants**

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

### **Leasing**

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

#### **The Group as lessor**

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

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

#### **The Group as lessee**

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

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

### **Foreign currencies**

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

## 2. Significant accounting policies *continued*

### *Borrowing costs*

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

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

### *Operating profit*

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

### *Retirement benefit costs*

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

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

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

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

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

### *Tax*

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

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

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

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

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

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

### *Property, plant and equipment – the railway network*

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

### *Valuation methodology*

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

### *Depreciation*

The railway network is depreciated on a straight-line basis over its estimated remaining weighted average useful economic life. The estimated remaining weighted average useful economic life of the network is currently 30 years (2011: 30 years). The remaining useful economic lives of network assets are estimated annually, with external verification of the valuation and asset lives carried out where required.

## **2. Significant accounting policies** continued

### **Investment property**

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

### **Research and development**

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

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

### **Intangible assets**

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

### **Inventories**

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

### **Financial instruments**

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

### **Financial assets**

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

### **Financial assets at FVTPL**

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

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

### **Impairment of financial assets**

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

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

## **2. Significant accounting policies** continued

### **Cash and cash equivalents**

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

### **Joint ventures**

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

### **Financial liabilities**

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

#### **Financial liabilities at FVTPL**

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

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

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

### **Debt**

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

### **Trade payables**

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

### **Derivative financial instruments and hedge accounting**

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

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

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

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

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

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

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

## 2. Significant accounting policies *continued*

### *Fair value hedges*

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

### *Cash flow hedges*

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

### *Provisions*

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

### *Critical accounting judgements and key sources of uncertainty*

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

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

(iii) Retirement benefit obligations – the Group recognises and discloses its retirement benefit obligation in accordance with the measurement and presentational requirement of IAS 19 'Employee Benefits'. The calculations include a number of judgements and estimations in respect of the expected rate of return on assets, the discount rate, inflation assumptions, the rate of increase in salaries and life expectancy amongst others. Changes in these assumptions can have a significant effect on the value of the retirement benefit obligation. The key assumptions made are set out in Note 28. The total contribution rate payable under the Railway Pension Scheme (RPS) and the Career Average Revalued Earnings (CARE) scheme is normally split in the proportion 60:40 between the Group and the members, respectively. The Group reflects its share of the contribution in the financial statements.

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

## 3. Revenue

	2012 Group £m	2011 Group £m
Franchised track access and grant income	5,706	5,408
Freight revenue	51	43
Property rental income	215	244
Other income	32	17
<b>Revenue for the year</b>	<b>6,004</b>	<b>5,712</b>

The net effect of the performance regimes on the results of the Group was a net income of £6m (2011: net loss of £14m).

## 4. Net operating costs

	2012 Group £m	2011 Group £m
Employee costs (see Note 6)	1,679	1,734
Own costs capitalised	(684)	(623)
Other external charges (including infrastructure maintenance costs)	1,594	1,601
Other operating income	(242)	(245)
<b>Net operating costs before depreciation</b>	<b>(2,347)</b>	<b>2,467</b>
Depreciation	1,378	1,271
Capital grants amortised	(68)	(64)
<b>Net operating costs</b>	<b>3,657</b>	<b>3,674</b>

## 5. Profit from operations

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

	2012 Group £m	2011 Group £m
Research and development costs expensed	2	1
Amortisation of intangible fixed assets	1	1
Profit on sale of properties	(27)	(12)
Decrease in the fair value of investment properties	8	1
Cost of inventories recognised as an expense	165	176
Write downs of inventories recognised as an expense	1	10

### Amounts payable to auditors

Fees payable to the Company's auditors for the audit of the Company's annual accounts	-	-
Fees payable to the Company's auditors for other services to the Group		
– The audit of the Company's subsidiaries pursuant to legislation	0.4	0.3
<b>Total audit fees</b>	<b>0.4</b>	<b>0.3</b>

### Other services pursuant to legislation

– Regulatory accounts audit and interim review	0.1	0.1
– Other	0.1	-
<b>Total non-audit fees</b>	<b>0.2</b>	<b>0.1</b>
<b>Total amounts payable to auditors</b>	<b>0.6</b>	<b>0.4</b>

## 6. Employee costs

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

	2012 Group Number	2011 Group Number
<b>Management and operation of the railway</b>	<b>35,253</b>	<b>35,606</b>

	2012 Group £m	2011 Group £m
<b>Their aggregate remuneration comprised:</b>		
Wages and salaries	1,489	1,465
Social security costs	131	121
Defined contribution pension costs (see Note 28)	14	17
Defined benefit pension costs – current service costs (see Note 28)	119	131
Defined benefit pension costs – past service costs (see Note 28)	(74)	-
	<b>1,679</b>	<b>1,734</b>

## 7. Investment revenue

	2012 Group £m	2011 Group £m
Interest receivable on investments and deposits	44	76
Interest receivable on finance leases	1	1
	<b>45</b>	<b>77</b>

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

	2012 Group £m	2011 Group £m
Loans and receivables (including cash and bank balances)	45	77
	<b>45</b>	<b>77</b>

## 8. Other gains and losses

	2012 Group £m	2011 Group £m
Net ineffectiveness arising from cash flow hedge accounting	(124)	(44)
Fair value loss on fair value hedges	(103)	(127)
Fair value gain on carrying value of fair value hedged debt	77	117
Losses arising from fair value hedge accounting	(26)	(10)
Net increase in fair value of non-hedge accounted debt	(8)	(20)
Loss on derivatives not hedge accounted	(409)	(109)
Losses arising from non-hedge accounting	(417)	(129)
<b>Total other losses</b>	<b>(567)</b>	<b>(183)</b>

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

The gain/loss arising on adjustment for the hedged item in a designated fair value hedge accounting relationship, the change in fair value of debt designated as fair value through profit and loss, and the exchange differences on retranslation of foreign currency debt form part of the net gains/losses on other financial liabilities carried at amortised cost and relate to debt issuances disclosed in Note 19.

The overall size of the debt and derivative movements will be significantly affected by the real interest rate hedging activities with regard to future index-linked debt issuance. Hedge accounting under IAS 39 has not been applied to this hedge of the real interest rate.

### Debt and derivative revaluations

The Income statement has been presented in a three-column format in order to allow users to appreciate the impact of the revaluation of debt and derivatives on the results for the year. Not all hedging strategies qualify for hedge accounting and the Directors believe that by separating gains and losses arising from applying the valuation requirements of IAS 39, the users of this financial information will better understand the underlying performance of the Group.

Those items that have been identified for disclosure as changes in debt and derivative valuations are explained above.

## 9. Finance costs

	2012 Group £m	2011 Group £m
Interest on bank loans and overdrafts	7	56
Interest on bonds issued under the Debt Issuance Programme	1,285	1,349
Expected return on assets less interest on liabilities in respect of defined benefit pension schemes	3	27
Other interest	200	186
<b>Total borrowing costs</b>	<b>1,495</b>	<b>1,618</b>
Less: capitalised interest	(126)	(117)
<b>Total finance costs</b>	<b>1,369</b>	<b>1,501</b>

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 5.6 per cent (2011: 5.8 per cent).

## 10. Tax

	2012 Group £m	2011 Group £m
<b>Current tax:</b>		
<b>UK Corporation tax at 26% (2011: 28%):</b>		
Corporation tax charge	(12)	(19)
Less advance corporation tax (ACT) set-off	5	13
Corporation tax liability	(7)	(6)
Prior year credit	15	(4)
<b>Total current tax</b>	<b>8</b>	<b>(10)</b>
<b>Deferred tax:</b>		
Deferred tax at 24% (2011: 26%)		
Current year charge	(96)	(131)
Effect of rate change	168	163
Prior year credit/(charge)	206	(144)
<b>Total deferred tax</b>	<b>278</b>	<b>(112)</b>
<b>Total tax</b>	<b>286</b>	<b>(122)</b>

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

	2012 Group £m	2011 Group £m
Profit before tax	475	442
Tax at the UK corporation tax rate of 26% (2011: 28%)	124	124
Adjustments in respect of prior years	(221)	148
Rate changes	(168)	(163)
Permanent differences	(16)	26
Advance corporation tax previously written off	(5)	(13)
<b>Tax charge for the year</b>	<b>(286)</b>	<b>122</b>

In addition to the amounts charged to the Income statement, deferred tax relating to the revaluation of the railway network amounting to a credit of £32m including the impact of the rate change (2011: £45m credit) has been charged directly to equity. Movements on the hedging reserve amounted to a £50m charge including the impact of the rate change (2011: £55m credit). Movements relating to retirement benefit obligations amounted to a £47m credit to equity including the impact of the rate change (2011: £160m charge). The adjustment in respect of prior years relates to reassessments of provisions for deductions in capital allowances.

Deferred tax is calculated at a rate of 24 per cent (2011: 26 per cent). 24 per cent (2011: 26 per cent) is also used for the reconciliation above as the tax charge is substantively deferred tax.

UK corporation tax is calculated at 26 per cent (2011: 28 per cent). Further reductions to the UK tax rate have been announced. The changes, which are expected to be enacted separately each year, propose to reduce the tax rate by 1% per annum to 23% by 1 April 2014. The changes had not been substantively enacted at the balance sheet date and, therefore, are not recognised in these financial statements.

The Group has £35m (2011: £29m) of surplus ACT carried forward. No deferred tax asset has been provided in respect of this amount.

## 11. Intangible assets

Group	Concessions £m
<b>Cost</b>	
At 1 April 2010, 31 March 2011 and 31 March 2012	78
<b>Amortisation</b>	
At 1 April 2010	(6)
Charge for the year	(1)
<b>At 31 March 2011</b>	<b>(7)</b>
Charge for the year	(1)
<b>At 31 March 2012</b>	<b>(8)</b>
<b>Carrying amount</b>	
At 31 March 2012	<b>70</b>
At 31 March 2011	71

The intangible assets above relate to the concession to run the operations, maintenance and renewal business of the Channel Tunnel Rail Link, and are held by the Company's wholly owned subsidiary Network Rail (CTRL) Limited.

Intangible assets are being amortised over 84 years, to 2086. Amortisation is charged to net operating costs in the Income Statement.

## 12. Property, plant and equipment – the railway network

	Group £m	Company £m
<b>Valuation</b>		
At 1 April 2010	36,629	–
Additions	3,997	–
Depreciation charge for the year	(1,271)	–
Revaluation in the year	222	–
<b>At 31 March 2011</b>	<b>39,577</b>	<b>–</b>
Additions	4,600	–
Depreciation charge for the year	(1,378)	–
Revaluation in the year	313	–
<b>At 31 March 2012</b>	<b>43,112</b>	<b>–</b>

Given the interdependency of the assets comprising the railway network, the Group has concluded that the railway network is a single class of asset. The railway network is carried at its fair value, which is measured as the estimated future cash flows that are expected to be generated in perpetuity, discounted at the Group's pre-tax rate of return, as set by the independent rail regulator, the Office of Rail Regulation (the ORR), in its Access Charges Review. This rate reflects the risks and opportunities that exist in the regulated market for railway infrastructure assets and equates to the cost of capital for this market.

### *The Regulatory Asset Base (RAB) is a proxy for the present value of future cash flows*

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

The income approach to determining the fair value of the railway network involves using the RAB, which is a proxy for a discounted cash flow calculation, adjusted for forecast performance variations.

## 12. Property, plant and equipment – the railway network *continued*

The RAB is used by the ORR to set Network Rail's charges to customers and is a proxy for the present value of future cash flows.

Annual income (receivable as track access charges and the network grant) comprises three elements:

- a) Efficient operating and maintenance costs – paid to Network Rail as they are expected to be incurred
- b) RAB amortisation – capital expenditure is added to the RAB as incurred in order to spread the cost to customers and stakeholders of investment in the railway network over many years. The ORR allows Network Rail to recover these costs through amortisation of the RAB
- c) Allowed return – calculated by applying the rate of return permitted by the ORR (based on its assessment of the market's cost of capital) to the RAB balance. If this rate of return changes, then this element of the Group's income changes, but the RAB does not change.

The RAB is a proxy for the present value of the future cash flows because the net cash flow that the Group is allowed to earn is the RAB multiplied by the rate of return allowed by the regulator, which reflects the risks and opportunities that exist in the regulated market for railway infrastructure assets. This rate equates to the market's pre-tax cost of capital.

### *Discount rate*

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

The Group's annual revaluation includes an assessment of the discount rate set by the ORR to determine whether it continues to reflect current conditions in the market. Should this assessment show that the market cost of capital is materially different to the rate set by the ORR, this will be reflected in the valuation.

The permitted rate of return was determined by the ORR, for the five years to April 2014, to be 4.75 per cent. Should the ORR amend the permitted rate of return in future quinquennial reviews, the regulator would raise or lower the Group's permitted charges to customers so as to achieve this rate of return. In other words, the cash flows would change but the RAB would not. The RAB is therefore a proxy for the present value of future cash flows.

In the most recent Access Charges Review, the ORR set out its purpose in setting this rate as:

- a) reflecting risks in delivering the capital programme of works;
- b) ensuring comparability between Network Rail and competitors for the delivery of enhancements; and
- c) enabling the Group to raise debt at a reasonable price.

The rate of return set by the regulator is, at each quinquennial review date, consistent with the market discount rates for infrastructure assets. Movements in the market cost of capital within a review period would have a small effect on the valuation of the railway network. However, at the start of the next review period, the regulator will re-evaluate the rate of return and reset it to the market rate. Changes in the fair value of the railway network resulting from movements in the market rate would not be permanent – only lasting until the next review.

The Group's annual valuation includes a reassessment of this rate to determine whether it continues to reflect conditions in the market in between review dates. This assessment is by reference to movements in observable market data, including the risk-free cost of borrowing, and changes in the weighted average cost of capital of listed utilities with similar gearing ratios. The most recent assessment has shown that there has been no material change in cost of capital within the control period to date.

The following table shows the effect of changes in the market discount rate on the carrying value of the railway network and on the depreciation charge. The analysis only considers the effects of movements in the market discount rate until the end of the control period (2014), and not in perpetuity. This is because the regulator performs a review every five years, so the rate applicable to the income streams derived from the railway network will be rebased to the market every five years. The effects of changes in the market discount rate apply equally to increases and to decreases in discount rates.

## 12. Property, plant and equipment – the railway network *continued*

	Change in cost of capital (basis points)	31 March 2012	31 March 2011
Change in fair value	25	<b>£190m</b>	£273m
	50	<b>£379m</b>	£548m
% change in fair value	25	<b>0.5%</b>	0.7%
	50	<b>1.0%</b>	1.5%
Change in annual depreciation charge	25	<b>£6m</b>	£9m
	50	<b>£13m</b>	£18m

These sensitivities are calculated by reference to the Regulatory Asset Base used by the ORR to determine the allowed return, equal to the regulatory determination of the cost of capital, as set out in the ORR's *Periodic Review 2008: Determination of Network Rail's outputs and funding 2009-14*. Twenty five and fifty basis points were chosen as management's assessment of reasonably possible changes in the market cost of capital.

The sensitivities calculated the discounted additional income or expense that could arise if the actual cost of capital varied from the regulatory cost of capital between quinquennial reviews.

### *Forecast performance variations*

The annual valuation includes a review of changes in cash flow estimates and an assessment of current operational and economic conditions, as well as operational and political risk. These changes are reflected in the valuation so that the resulting fair value of the railway network remains current throughout the five years between periodic reviews.

### *Critical judgements*

The valuation also includes the following critical judgements:

- Cash flows remain stable and robust. The regulatory financial framework has remained robust and stable over recent years and is expected to continue to be so in the future.
- The residual value of the railway network is considered immaterial to assessing its annual depreciation charge. This is because evidence from other disused parts of the railway network indicates that the residual value is negligible and includes significant onerous obligations. In addition, the value of the land on which the railway network stands is immaterial to the value of the assets that comprise the network.
- The quinquennial charges review sets out renewals allowances that can be added to the RAB. The allowances take account of input prices using the Infrastructure Output Prices Index (IOPI) as published by the Royal Institution of Chartered Surveyors. The expected future changes in IOPI in comparison to RPI, on which the Group's income flows are based, is a critical judgement to the railway network valuation. The expected future changes reduce the network valuation by £355m (2011: £290m). This forecast is based on management's expectations that IOPI will broadly track general economic inflation as measured by RPI over the remainder of the five-year period. The renewals allowances, and therefore the valuation, would change by £75m for every one per cent change in IOPI in comparison to RPI over the two years to the end of the current quinquennial review period at 31 March 2014.

### *Depreciated replacement cost*

In the year ended 31 March 2009 Ove Arup and Partners reviewed Network Rail Infrastructure Limited's engineering assessment of the serviceable economic lives of the major asset categories that comprise the railway network and their depreciated replacement cost. They confirmed in writing to the Directors that the basis upon which the assessment had been prepared was reasonable.

The depreciated replacement cost of the network (after excluding the replacement cost of embankments, cuttings and tunnels) is estimated at £75bn (2011: £75bn).

As at 31 March 2012 the comparable valuation of the railway network according to the historical cost convention is £38,372m (2011: £35,015m).

As at 31 March 2012 and 31 March 2011 it has not been possible to identify the undepreciated capitalised interest or the undepreciated finance leases within the net book value of fixed assets. The undepreciated interest capitalised since the date of adoption of the network value at deemed cost on 1 April 2002 was £660m (2011: £555m). No finance leased assets have been acquired since 1 April 2002.

The depreciation charge for the year is calculated using the average carrying value for the year and the estimated weighted average remaining useful economic life of the railway network. The weighted average remaining useful economic life of the railway network was calculated using the engineering assessment of serviceable economic lives of the major categories of asset that comprise the railway network. The estimated weighted average remaining useful economic life of the network is currently 30 years (2011: 30 years).

At 31 March 2012, the Group had entered into contractual commitments in respect of capital expenditure amounting to £1,706m (2011: £1,501m).

### 13. Investment property

	Group £m	Company £m
<b>Fair value</b>		
At 1 April 2010	764	–
Additions	15	–
Decrease in fair value in the year	(1)	–
<b>At 1 April 2011</b>	<b>778</b>	<b>–</b>
Additions	110	–
Disposals	(2)	–
Decrease in fair value in the year	(8)	–
<b>At 31 March 2012</b>	<b>878</b>	<b>–</b>

In September 2011 the Group purchased the Victoria Place Shopping Centre for £92m. The Directors believe the cost reflects its fair value at 31 March 2012.

The fair values of the remainder of the Group's investment properties at 31 March 2012 have 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 chartered surveyor working for Network Rail.

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

Jones Lang LaSalle provided independent valuations of 15 one-off individual properties, amounting to 11 per cent of the total valuation. The balance of the estate was valued under the Beacon method by splitting the portfolio into 12 homogeneous classes of property and areas. Jones Lang LaSalle independently assessed the appropriate yield to be adopted within each of these classes and areas. This enabled the directors to estimate market values by applying the provided yields to the net rental income from these properties, in accordance with a standard UK investment property valuation.

The property rental income earned by the Group from its investment property, all of which is leased out under operating leases, amounted to £85m (2011: £76m). Direct operating expenses arising on the investment properties in the year amounted to £6m (2011: £5m).

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

## 14. Investment in subsidiaries: Company

### Shares in Group undertakings

At cost  
£m

Investment in subsidiaries at 1 April 2010, 31 March 2011 and 31 March 2012

–

The Company's principal subsidiaries are set out below:

<b>Directly owned</b>	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
<b>Owned through subsidiary</b>			
Network Rail Infrastructure Limited	Great Britain	100 %	Insurance
Network Rail Insurance Limited	Guernsey	100 %	Management of GB railway infrastructure
Network Rail (CTRL) Limited	Great Britain	100 %	Holds St Pancras concession and CTRL Railway Services Agreement
Network Rail Development Limited	Great Britain	100 %	Holds 49.95 % of the property joint venture Solum Regeneration Limited Partnership
Solum Regeneration (GP) Limited	Great Britain	50 %	Holds 0.1 % of the property joint venture Solum Regeneration Limited Partnership
Network Rail Pension Trustee Limited	Great Britain	Company limited by guarantee	Administration of defined contribution pension scheme
Network Rail (NDS-Plant) Limited	Great Britain	100 %	Provider of rail-road vehicles
<b>Shares held by a trustee</b>			
Network Rail Infrastructure Finance PLC	Great Britain	Shares held by HSBC Trustee (C.I.) Limited	Issuer of the Debt Issuance Programme

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

The Group's joint venture is set out below:

<b>Joint venture</b>	Country of incorporation	Proportion of all classes of issued share capital owned by the Group	Principal activity
Solum Regeneration Limited Partnership	Great Britain	50 %	Property development

### Aggregated amounts relating to joint ventures

	2012 £m	2011 £m
Current assets	6	5

## 15. Inventories

	2012 Group £m	2011 Group £m
Raw materials and consumables	125	108

As at 31 March 2012 a provision of £29m was held in respect of inventories (2011: £28m).

## 16. Finance lease receivables

	Minimum lease payments		Present value of minimum lease payments	
	2012 Group £m	2011 Group £m	2012 Group £m	2011 Group £m
<b>Amounts receivable under finance leases:</b>				
Within one year	2	2	1	1
In the second to fifth years inclusive	5	6	5	5
After five years	–	1	–	1
	<b>7</b>	<b>9</b>	<b>6</b>	<b>7</b>
Less: unearned finance income	(1)	(2)	n/a	n/a
<b>Present value of minimum lease payments receivable</b>	<b>6</b>	<b>7</b>	<b>6</b>	<b>7</b>
Analysed as:				
Current finance lease receivables (recoverable within one year)	1	1	1	1
Non-current finance lease receivables (recoverable after one year)	5	6	5	6
	<b>6</b>	<b>7</b>	<b>6</b>	<b>7</b>

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

The interest rate inherent in the leases is fixed at the contract date for all of the lease term. The average effective interest rate contracted is approximately 8.4 per cent (2011: 8.4 per cent) per annum.

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

The fair value of the Group's finance lease receivables at 31 March 2012 is estimated at £6m (2011: £7m) using a 1.8 per cent (2011: 3.4 per cent) discount rate based on the average cost of capital associated with the remaining life of the lease.

## 17. Trade and other receivables

	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
Trade receivables	201	320	–	–
Capital grants receivable	133	320	–	–
Other taxation and social security	80	32	–	–
Other receivables	38	27	–	–
Prepayments and accrued income	220	211	–	–
	<b>672</b>	<b>910</b>	<b>–</b>	<b>–</b>

Trade receivables include an allowance for estimated irrecoverable amounts from the supply of services of £23m (2011: £24m). This allowance has been made by reference to past default experience. Average debtor days were 46 days (2011: 53 days).

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

The Group's credit risk is primarily attributable to its trade receivables. Around 95 per cent of the Group's income is received from train operating companies (TOCs) and in the form of revenue grants from Government. Franchises are issued to TOCs by the Department for Transport (DfT) in England and Wales and Transport Scotland in Scotland. The Group believes that amounts receivable from Government and the TOCs represent a high level of credit quality. This is because in the extraordinary circumstance that a TOC were to be 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 £32m (2011: £14m) which are past due at the reporting date for which the Group has not provided as there has not been a significant change in the credit quality and the amounts are still considered recoverable. The Group does not hold collateral over these balances. The average age of these receivables is 31 days (2011: 41 days).

### 17. Trade and other receivables *continued*

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

	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
Past due by 1 – 28 days	24	9	–	–
Past due by 29 – 56 days	4	1	–	–
Past due by 57 – 84 days	2	2	–	–
Past due by 85 – 180 days	2	2	–	–
	<b>32</b>	<b>14</b>	<b>–</b>	<b>–</b>

### 18. Trade and other payables

#### *Current liabilities: Trade and other payables*

	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
Trade payables	611	651	–	–
Collateral held from banking counterparties	81	159	–	–
Payments received on account	16	26	–	–
Other payables	370	558	–	–
Other interest accruals	250	275	–	–
Other accruals and deferred income	1,376	1,154	–	–
	<b>2,704</b>	<b>2,823</b>	<b>–</b>	<b>–</b>

The average credit period taken for trade purchases is 41 days (2011: 49 days).

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

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

#### *Non-current liabilities: Other payables*

	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
Capital grants deferred income	2,468	2,323	–	–
Other payables	301	171	–	–
	<b>2,769</b>	<b>2,494</b>	<b>–</b>	<b>–</b>

## 19. Borrowings

	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
1.085% sterling index linked bond due 2052	115	111	-	-
0% sterling index linked bond due 2052	104	103	-	-
1.003% sterling index linked bond due 2051	22	21	-	-
0.53% sterling index linked bond due 2051	112	107	-	-
0.517% sterling index linked bond due 2051	112	106	-	-
0% sterling index linked bond due 2051	120	115	-	-
0.678% sterling index linked bond due 2048	111	107	-	-
1.125% sterling index linked bond due 2047	4,094	3,587	-	-
0% sterling index linked bond due 2047	72	65	-	-
1.1335% sterling index linked bond due 2045	45	44	-	-
1.5646% sterling index linked bond due 2044	251	238	-	-
1.1565% sterling index linked bond due 2043	51	49	-	-
1.1795% sterling index linked bond due 2041	62	60	-	-
1.2219% sterling index linked bond due 2040	248	236	-	-
1.2025% sterling index linked bond due 2039	68	65	-	-
4.6535% sterling bond due 2038	100	100	-	-
1.375% sterling index linked bond due 2037	4,428	4,085	-	-
4.75% sterling bond due 2035	1,225	1,224	-	-
1.6492% sterling index linked bond due 2035	378	359	-	-
4.375% sterling bond due 2030	870	870	-	-
1.75% sterling index linked bond due 2027	3,892	3,193	-	-
4.615% Norwegian krone bond due 2026*	56	54	-	-
4.57% Norwegian krone bond due 2026*	16	15	-	-
1.9618% sterling index linked bond due 2025	318	301	-	-
4.75% sterling bond due 2024	729	728	-	-
2.76% Swiss franc bond due 2021	208	204	-	-
2.315% Japanese yen bond due 2021*	83	82	-	-
2.28% Japanese yen bond due 2021*	83	81	-	-
2.15% Japanese yen bond due 2021*	82	80	-	-
4.625% sterling bond due 2020	997	997	-	-
6% Australian dollar bond due 2016	323	322	-	-
4.4% Canadian dollar bond due 2016	312	321	-	-
1.25% US dollar bond due 2016	625	-	-	-
4.875% sterling bond due 2015	995	994	-	-
1.25% sterling bond due 2015	1,497	-	-	-
0.875% US dollar bond due 2015	940	-	-	-
2.5% sterling bond due 2014	1,006	748	-	-
1.5% US dollar bond due 2014	1,111	939	-	-
Floating rate US dollar bond 2013	719	-	-	-
3.5% US dollar bond due 2013	780	778	-	-
1.75% US dollar bond due 2013	633	635	-	-
Floating rate US dollar bond 2012	63	-	-	-
4.875% sterling bond due 2012	-	998	-	-
2% US dollar bond due 2012	-	624	-	-
0.54% US dollar bond due 2012	-	62	-	-
0.52% US dollar bond due 2012	63	-	-	-
5.25% US dollar bond due 2011	-	627	-	-
	<b>28,119</b>	<b>24,435</b>	-	-
Included in current liabilities	856	2,311	-	-
Included in non-current liabilities	27,263	22,124	-	-
Bonds issued under the Debt Issuance Programme	<b>28,119</b>	<b>24,435</b>	-	-

\* Amounts are shown as fair value through profit and loss. All other amounts are shown net of unamortised discount and fees.

## 19. Borrowings continued

The amounts repayable on maturity relating to those bonds designated to be measured at fair value through profit and loss, are as follows:

	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
4.57 % Norwegian krone bond due 2026	16	16	–	–
4.615 % Norwegian krone bond due 2026	55	56	–	–
2.28 % Japanese yen bond due 2021	75	75	–	–
2.315 % Japanese yen bond due 2021	75	75	–	–
2.15 % Japanese yen bond due 2021	75	75	–	–
	<b>296</b>	<b>297</b>	<b>–</b>	<b>–</b>

Bank loans and overdrafts are analysed as follows:

	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
Index-linked European Investment Bank due 2036 (£212m) and 2037 (£212m)	424	402	–	–
Commerzbank (novated from RBS)	–	208	–	–
Barclays Bank due 2017 repayable by instalments	42	47	–	–
Commerzbank (novated from RBS)	–	69	–	–
5.57 % European Investment Bank due 2013	201	202	–	–
5.77 % European Investment Bank due 2012	300	303	–	–
	<b>967</b>	<b>1,231</b>	<b>–</b>	<b>–</b>

During the year the Commerzbank loans were terminated early as part of a restructuring exercise by Commerzbank of its balance sheet. The termination of these loans resulted in a profit of £25m for the Group.

At 31 March 2012 and 2011 the Group had the following undrawn committed borrowing facilities:

	2012 Drawn £m	2012 Undrawn £m	2012 Total £m	2011 Drawn £m	2011 Undrawn £m	2011 Total £m
Working capital facility	–	1,000	1,000	–	1,000	1,000
Standby facility A	–	4,000	4,000	–	4,000	4,000
	–	<b>5,000</b>	<b>5,000</b>	–	<b>5,000</b>	<b>5,000</b>

Undrawn committed facilities expire as follows:

	2012 Group £m	2011 Group £m
Within one year	1,000	–
Within one to two years	–	1,000
Within two to five years	4,000	4,000
	<b>5,000</b>	<b>5,000</b>

The £1bn working capital facility expired on 25 April 2012. The Directors have decided not to renew the facility and will hold sufficient cash to provide liquidity.

In addition the Secretary of State for Transport has provided unlimited financial indemnity in respect of borrowings under the Debt Issuance Programme.

## 20. Derivative financial instruments

	2012 Group	Notional amounts £m
	Fair value £m	
<b>Cash flow hedges</b>		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	490	1,222
<b>Fair value hedges</b>		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	26	1,094
<b>Non-hedge accounted derivatives</b>		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	153	198
Interest rate swaps	4	1,750
Forward foreign exchange contracts	–	12
	<b>673</b>	<b>4,276</b>
Included in non-current assets	672	4,202
Included in current assets	1	74
<b>Derivative financial instrument assets</b>	<b>673</b>	<b>4,276</b>
<b>Cash flow hedges</b>		
Interest rate swaps	(102)	583
Forward starting interest rate swaps	(161)	2,600
<b>Fair value hedges</b>		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	(122)	3,122
<b>Non-hedge accounted derivatives</b>		
Interest rate swaps to hedge debt issued under the Debt Issuance Programme	(437)	4,400
Forward starting real interest rate swaps and gilt locks	(385)	847
Forward foreign exchange contracts	(1)	54
	<b>(1,208)</b>	<b>11,606</b>
Included in current liabilities	(411)	1,608
Included in non-current liabilities	(797)	9,998
<b>Derivative financial instrument liabilities</b>	<b>(1,208)</b>	<b>11,606</b>

## 20. Derivative financial instruments continued

	2011 Group	
	Fair value £m	Notional amounts £m
<b>Cash flow hedges</b>		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	440	1,222
<b>Fair value hedges</b>		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	103	547
<b>Non-hedge accounted derivatives</b>		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	134	198
Forward starting real interest rate swaps and gilt locks	3	100
Forward foreign exchange contracts	–	1
	680	2,068
Included in non-current assets	576	1,520
Included in current assets	104	548
<b>Derivative financial instrument assets</b>	680	2,068
<b>Cash flow hedges</b>		
Cross-currency swaps to hedge debt under the Debt Issuance Programme	(29)	658
Interest rate swaps	(113)	1,501
Forward starting interest rate swaps	(336)	5,870
<b>Fair value hedges</b>		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	(70)	1,698
<b>Non-hedge accounted derivatives</b>		
Interest rate swaps to hedge debt issued under the Debt Issuance Programme	(80)	870
Forward starting real interest rate swaps and gilt locks	(319)	1,746
Forward foreign exchange contracts	–	2
	(947)	12,345
Included in current liabilities	(373)	3,126
Included in non-current liabilities	(574)	9,219
<b>Derivative financial instrument liabilities</b>	(947)	12,345

## 21. Provisions: Group

	£m
<b>At 1 April 2011</b>	<b>17</b>
Additional provision in the year	4
Utilisation of provision	(3)
Release of provision	(6)
<b>At 31 March 2012</b>	<b>12</b>
Included in current liabilities	12
Included in non-current liabilities	–
	<b>12</b>

The Group has provided against a number of commercial claims from third parties arising from interpretations of legal contracts or past events for which settlement is expected to be achieved in the next year, but could be deferred to future years depending on the legal interpretation of rights and responsibilities under the contracts as well as commercial negotiation. The provisions that have been recorded represent the Directors' best estimate of the expenditure required to settle the obligation, often with the benefit of legal advice.

### Contingent liability

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

The Group's lawyers have advised that the provisions for the claims are realistic and no further provision is made for contingent liabilities as the Directors do not consider there is any probable loss. In accordance with paragraph 92 of IAS 37 the Directors consider that further disclosure regarding the nature and amount of the disputes beyond that disclosed here could be expected to prejudice seriously the position of the Group.

## 22. 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.

<b>Group</b>	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
<b>At 1 April 2010</b>	<b>3,406</b>	<b>1,434</b>	<b>(280)</b>	<b>(103)</b>	<b>(1,253)</b>	<b>3,204</b>
Charge/(credit) to income	42	–	(9)	11	77	121
(Credit)/charge to other comprehensive income	–	(45)	160	(55)	–	60
<b>At 1 April 2011</b>	<b>3,448</b>	<b>1,389</b>	<b>(129)</b>	<b>(147)</b>	<b>(1,176)</b>	<b>3,385</b>
(Credit)/charge to income	(202)	–	(26)	(116)	66	(278)
(Credit)/charge to other comprehensive income	–	(32)	(47)	50	–	(29)
<b>At 31 March 2012</b>	<b>3,246</b>	<b>1,357</b>	<b>(202)</b>	<b>(213)</b>	<b>(1,110)</b>	<b>3,078</b>

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

	2012 £m	2011 £m
Deferred tax liabilities	<b>4,603</b>	4,837
Deferred tax assets	<b>(1,525)</b>	(1,452)
	<b>3,078</b>	3,385

### 23. Obligations under finance leases

	Minimum lease payments		Present value of minimum lease payments	
	2012 Group £m	2011 Group £m	2012 Group £m	2011 Group £m
<b>Amounts payable under finance leases:</b>				
Within one year	1	1	1	1
In the second to fifth years inclusive	–	1	–	1
After five years	–	–	–	–
	1	2	1	2
Less: future finance charges	–	–	n/a	n/a
<b>Present value of lease obligations</b>	<b>1</b>	<b>2</b>	<b>1</b>	<b>2</b>
Less: amounts repayable within one year (shown under current liabilities)	1	–	1	–
<b>Amounts repayable after more than one year</b>	<b>–</b>	<b>2</b>	<b>–</b>	<b>2</b>

The Group leases certain fixtures and fittings under finance leases from third parties. All lease obligations are denominated in sterling. The fair value of the Group's lease obligations approximates to their carrying amount. The Group's obligations under finance leases are secured by the lessors' charges over the leased assets. For the year ended 31 March 2012, the effective borrowing rate was 7.4 per cent (2011: 7.4 per cent). Interest rates are fixed at contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rent payments.

### 24. Notes to the statements of cash flows

	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
Operating profit	2,347	2,038	–	–
Adjustments for:				
Depreciation of the railway network	1,378	1,271	–	–
Amortisation of capital grants	(68)	(64)	–	–
Amortisation of intangible assets	1	1	–	–
Movement in retirement benefit obligations	(72)	–	–	–
Decrease in provisions	(5)	(39)	–	–
<b>Operating cash flows before movements in working capital</b>	<b>3,581</b>	<b>3,207</b>	<b>–</b>	<b>–</b>
(Increase)/decrease in inventories	(17)	24	–	–
Decrease in receivables	47	52	–	–
Increase in payables	50	139	–	–
<b>Cash generated from operations</b>	<b>3,661</b>	<b>3,422</b>	<b>–</b>	<b>–</b>
Interest paid	(970)	(936)	–	–
<b>Net cash generated from operating activities</b>	<b>2,691</b>	<b>2,486</b>	<b>–</b>	<b>–</b>

#### Cash and cash equivalents

Cash and cash equivalents (which are represented as a single class of assets on the face of the Balance sheet) comprise cash at bank, collateral, commercial paper and money market deposit investments, all of which are on call with the exception of £20m of short-term deposits with an average term of two days (2011: £21m one day) from the Balance sheet date. In 2011/12 cash and money market deposits had an average maturity of one day (2011: one day) from the Balance sheet date.

## 25. Analysis of changes in net debt

	At 1 April 2011 £m	Cash flows £m	Non-cash movements £m	Capital accretion £m	Fair value through profit and loss and fair value hedging movements £m	Foreign exchange movements £m	At 31 March 2012 £m
Cash and cash equivalents*	612	1,193	–	–	–	–	1,805
Borrowings due within one year	(2,317)	2,043	(931)	–	81	(33)	(1,157)
Borrowings due after one year	(23,349)	(4,987)	937	(521)	(12)	3	(27,929)
Obligations under finance leases	(2)	1	–	–	–	–	(1)
	<b>(25,056)</b>	<b>(1,750)</b>	<b>6</b>	<b>(521)</b>	<b>69</b>	<b>(30)</b>	<b>(27,282)</b>

	At 1 April 2010 £m	Cash flows £m	Non-cash movements £m	Capital accretion £m	Fair value through profit and loss and fair value hedging movements £m	Foreign exchange movements £m	At 31 March 2011 £m
Cash and cash equivalents*	1,767	(1,155)	–	–	–	–	612
Borrowings due within one year	(2,227)	1,860	(2,359)	–	65	344	(2,317)
Borrowings due after one year	(23,385)	(1,716)	2,361	(657)	32	16	(23,349)
Obligations under finance leases	(2)	–	–	–	–	–	(2)
	<b>(23,847)</b>	<b>(1,011)</b>	<b>2</b>	<b>(657)</b>	<b>97</b>	<b>360</b>	<b>(25,056)</b>

\* Excludes collateral held of £81m (2011: £159m).

## 26. Operating lease arrangements

### The Group as lessee

	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
Minimum lease payments under operating leases recognised in the Income statement in the year	38	40	–	–

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:

	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
Within one year	37	36	–	–
In the second to fifth years inclusive	120	82	–	–
After five years	98	102	–	–
	<b>255</b>	<b>220</b>	<b>–</b>	<b>–</b>

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 required for maintenance and renewal activities.

### The Group as lessor

Operating lease rentals earned in the year by the Group were £232m (2011: £261m). This amount includes property rental income of £215m (2011: £244m), as disclosed in Note 3, and a portion of track access income (being income earned from station and depot leases to train operating companies).

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

	2012 Group £m	2011 Group £m	2012 Company £m	2011 Company £m
Within one year	336	395	–	–
In the second to fifth years inclusive	640	861	–	–
After five years	1,104	1,103	–	–
	<b>2,080</b>	<b>2,359</b>	<b>–</b>	<b>–</b>

## 27. Funding and financial risk management

### Introduction

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

The DIP allows access, through a single platform, to the widest possible sources of funding, at the lowest possible cost, including the long-term capital markets. This gives Network Rail a stable base for funding a continuing programme of long-term investments in the national rail network. Debt is issued in a number of currencies and a range of maturities which gives rise to interest rate, foreign currency and inflation risk. Financial risk management aims to mitigate these risks.

### Externally imposed capital requirements

The financial framework in which Network Rail operates is framed by the value of its debt, and the RAB. The Network Rail Group raises finance by issuing debt and therefore manages its debt as the key part of its capital. Network Rail manages its debt in relation to the RAB and its finance costs in relation to the allowed return on the RAB.

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

Network Rail's charges to customers are determined by the ORR. A key component of these charges is the allowed return on the RAB, as this is set at the ORR's assessment of the weighted average cost of capital in this market.

The RAB and regulatory debt are reconciled to property, plant and equipment (in Note 12) and net debt (in Note 25) as follows:

The debt to RAB ratio is based on regulatory net debt, which recognises debt at hedged rates.

	2012 £m	2011 £m
Net debt note per Note 25	(27,282)	(25,056)
Revaluations and remeasurements	793	580
Regulatory net debt	(26,489)	(24,476)

The RAB used to calculate the debt to RAB ratio is:

	2012 £m	2011 £m
Railway network per Note 12	43,112	39,577
Investment properties	878	778
Capital grant funded assets	(2,251)	(2,086)
Other fair value adjustments	632	325
<b>RAB</b>	<b>42,371</b>	<b>38,594</b>

The debt to RAB ratio at 31 March 2012 and 2011 was as follows:

	2012	2011
Debt: RAB ratio	62.5%	63.4%

The Group owns and operates Britain's rail network under licence from the ORR. The licence imposes conditions on the Group with regard to its net debt. Should the value of the Group's qualifying net debt exceed 72.5 per cent of the ORR's RAB then the ORR will be formally notified.

### Significant accounting policies

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

## 27. 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 2012 and 2011.

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

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

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

<b>Group</b>	2012		2011	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
<b>Financial assets</b>				
Cash and cash equivalents	1,886	1,886	771	771
Other non-derivative financial assets				
Finance lease receivables	6	6	7	7
Trade and other receivables (less prepayments and accrued income and other taxation and social security)	372	372	662	662
<b>Derivatives</b>				
Derivatives designated as cash flow hedging instruments	490	490	440	440
Derivatives designated as fair value hedging instruments	26	26	103	103
Other derivatives	157	157	137	137
Total derivatives	673	673	680	680
<b>Total financial assets</b>	<b>2,937</b>	<b>2,937</b>	<b>2,120</b>	<b>2,120</b>
<b>Financial Liabilities</b>				
Financial liabilities held at amortised cost				
Obligations under finance leases	(1)	(1)	(2)	(2)
Bank loans	(967)	(1,130)	(1,233)	(1,255)
Bonds issued under the Debt Issuance Programme	(27,799)	(33,892)	(24,121)	(26,008)
Financial liabilities designated as fair value through profit and loss				
Bonds issued under the Debt Issuance Programme	(320)	(320)	(312)	(312)
Total borrowing	(29,087)	(35,343)	(25,668)	(27,577)
Trade and other payables at amortised cost	(2,835)	(2,835)	(2,826)	(2,826)
<b>Derivatives</b>				
Derivatives designated as cash flow hedging instruments	(263)	(263)	(478)	(478)
Derivatives designated as fair value hedging instruments	(122)	(122)	(70)	(70)
Other derivatives	(823)	(823)	(399)	(399)
Total derivatives	(1,208)	(1,208)	(947)	(947)
<b>Total financial liabilities</b>	<b>(33,130)</b>	<b>(39,386)</b>	<b>(29,441)</b>	<b>(31,350)</b>

## **27. Funding and financial risk management** continued

### **Derivatives**

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

The Board of Network Rail Limited (the ultimate parent company of NRIL) through a treasury sub-committee (the Treasury Committee) have approved and monitor the risk management processes, including documented treasury policies, counterparty limits, controlling and reporting structures.

The use of derivative instruments can give rise to credit and market risk. Market risk is the possibility that future changes in foreign exchange rates and interest rates may make a derivative more or less valuable. Since the Group 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 for all classes of derivative financial instruments and other funds is limited because counterparties are banks with high credit ratings assigned by international credit-rating agencies. The Treasury Committee authorises the policy for setting counterparty limits based on credit ratings. The Group 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 counterparty suitability the risk is mitigated. The Treasury Committee also authorises the investment and borrowing instruments that can be used.

For debt designated as fair value through profit and loss (FVTPL) there has been no change in carrying value as a result of changes in own credit risk. The losses in the Income statement arising from the remeasurement of FVTPL debt items of £8m (2011: £20m) are all attributable to changes in market risk.

The credit risk with regard to all classes of derivative financial instruments is limited because Network Rail has arrangements in place which limit each bank to a threshold (based on credit ratings), which if breached requires the bank to post collateral in cash or eligible securities. The members of the banking group are required to post collateral on positive mark to market swaps above the threshold. At 31 March 2012 the fair value of collateral held was £81m (2011: £159m). The Group is the beneficial owner of this collateral. The Group is free to invest or otherwise utilise the collateral at its discretion, subject to acting within the authority sanctioned by the Treasury Committee. The reduction in collateral is mainly due to the maturity of in the money cross-currency swaps and the novation of interest rate swaps between Group companies to reduce the net level of risk in each company.

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

The Group considers its maximum exposure to credit risk to be the sum of its financial assets as set out on page 92.

### **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 per cent hedged and therefore no sensitivity analysis is produced.

### **Interest rate and inflation risk**

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

Debt with a carrying value of £27,744m (2011: £25,313m) is arranged at or swapped into fixed interest rates and exposes the Group to fair value interest rate risk. Other borrowings were arranged at or swapped into floating rates, thus exposing the Group to cash flow interest rate risk.

The Group has notional values of £2,600m (2011: £6,540m) of forward starting interest rate swaps which hedge Control Period 4. The average rate on these swaps is 5.06 per cent (2011: 5.03 per cent). The Group also has notional values of £100m (2011: £100m) of real rate swaps with an average real rate of -0.30 per cent (2011: -0.30 per cent) and notional values of £747m (2011: £1,746m) of gilt locks with an average real rate of 1.93 per cent (2011: 1.64 per cent).

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

## 27. Funding and financial risk management continued

### Sensitivity analysis

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

	Group 31 March 2012		Group 31 March 2011	
	Impact on the Income statement £m	Impact on equity £m	Impact on the Income statement £m	Impact on equity £m
1 % increase in the GBP interest rate	156	73	26	119
1 % increase in the GBP RPI on Index Linked Bonds	(218)	–	(124)	–

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

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

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

The Group believes that the above analysis is unrepresentative of the risks inherent in issuing index-linked debt. Franchised track access and grant income constitute £5,706m (2011: £5,408m) of revenue which is far in excess of an index-linked interest expense of £185m (2011: £171m). 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 is highly confident that this will continue to be the case. Therefore, the natural hedge that exists between finance costs and revenue mitigates the risk of RPI movements.

During the year the Group issued £790m of index-linked bonds, maintaining the proportion of index linked debt to nominal debt within the ratio set by the Treasury Committee. The Group restructured the maturities of part of its index-linked hedging portfolio, resulting in a net reduction of £209m in the notional value of gilt locks. That reduction, together with £790m of gilt locks that were used against the index linked debt issuance, reduced the index-linked hedging portfolio by £1bn. The sensitivity to movements in interest rates of the gilt lock portfolio is as follows:

<b>Change in real rate</b>	Effect on Income statement	
	2012	2011
1 % increase	£216m increase	£338m increase
1 % decrease	£282m decrease	£412m decrease

## 27. 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. Treasury provides sufficient liquidity to meet the Group's needs, while reducing financial risks and prudently maximising interest receivable and credit risk on surplus cash.

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

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

<b>Group</b>	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	Total £m
<b>31 March 2012</b>					
<b>Non derivative financial liabilities</b>					
Bank loans and overdrafts	331	223	37	539	1,130
<b>Bonds issued under the Debt Issuance Programme</b>					
– Sterling denominated DIP bonds	277	1,277	3,169	6,173	10,896
– Sterling denominated index-linked DIP bonds	198	205	658	44,208	45,269
– Foreign currency denominated bonds	969	2,608	2,353	590	6,520
Finance lease liabilities	1	–	–	–	1
Trade and other payables	2,396	189	–	–	2,585
<b>Derivative financial liabilities</b>					
Net settled derivative contracts	537	126	82	(57)	688
Gross settled derivative contracts – receipts	(970)	(2,607)	(2,353)	(590)	(6,520)
Gross settled derivative contracts – payments	1,006	2,516	2,203	417	6,142
	4,745	4,537	6,149	51,280	66,711

<b>Group</b>	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	Total £m
<b>31 March 2011</b>					
<b>Non derivative financial liabilities</b>					
Bank loans and overdrafts	49	340	275	1,500	2,164
<b>Bonds issued under the Debt Issuance Programme</b>					
– Sterling denominated DIP bonds	1,301	252	2,468	6,358	10,379
– Sterling denominated index-linked DIP bonds	176	182	585	41,063	42,006
– Foreign currency denominated bonds	1,173	581	1,771	689	4,214
Finance lease liabilities	–	–	1	–	1
Trade and other payables	2,490	61	–	–	2,551
<b>Derivative financial liabilities</b>					
Net settled derivative contracts	423	140	227	131	921
Gross settled derivative contracts – receipts	(1,173)	(581)	(1,771)	(689)	(4,214)
Gross settled derivative contracts – payments	1,342	744	2,001	640	4,727
	5,781	1,719	5,557	49,692	62,749

## 27. Funding and financial risk management continued

### Cash flow hedges

Contractual payments on derivatives designated as cash flow hedges impact the Income statement as they occur between the Balance sheet date, and will all have matured within the next ten years.

### Borrowings

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

### Fair value measurements recognised in the statement of balance sheets

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

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

	2012			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>Financial assets at FVTPL</b>				
Derivative financial assets	–	673	–	673
<b>Financial liabilities at FVTPL</b>				
Derivative financial liabilities	–	(1,208)	–	(1,208)
Financial liabilities designated at FVTPL	(320)	–	–	(320)
	(320)	(1,208)	–	(1,528)
<b>Total</b>	<b>(320)</b>	<b>(535)</b>	<b>–</b>	<b>(855)</b>

There were no transfers between Level 1 and 2 during the year.

	2011			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>Financial assets at FVTPL</b>				
Derivative financial assets	–	680	–	680
<b>Financial liabilities at FVTPL</b>				
Derivative financial liabilities	–	(947)	–	(947)
Financial liabilities designated at FVTPL	(312)	–	–	(312)
	(312)	(947)	–	(1,259)
<b>Total</b>	<b>(312)</b>	<b>(267)</b>	<b>–</b>	<b>(579)</b>

## 28. Retirement benefit schemes

### Defined contribution schemes

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

At 31 March 2012, the NRDCPS had 7,348 members (2011: 8,479) and the average employer contribution rate in the year was 5.1 per cent (2011: 5.3 per cent).

### Defined benefit schemes

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

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

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

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

Qualified actuaries Towers Watson have valued the schemes on an IAS 19 basis at 31 March 2012 and 31 March 2011.

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

The Group and members pay contributions of 17.4 per cent (2011: 17.0 per cent) and 11.6 per cent (2011: 11.4 per cent) of section pay respectively as at 31 March 2012 to RPS. The equivalent rates for the CARE scheme are 10.9 per cent and 7.2 per cent.

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

	2012 %	2011 %
<i>Key assumptions used:</i>		
Discount rate	5.2	5.6
Expected return on equity assets	6.7	7.3
Expected return on Government bond assets	3.1	4.4
Expected return on Non-Government bond assets	4.1	5.0
Expected return on property assets	6.3	6.0
Expected rate of price inflation	3.2	3.5
Future earnings increases*	4.2	4.5
Future pension increases – RPS	2.2	2.5
Future pension increases – CARE	3.2	3.5

\* Inclusive of a promotional salary scale of 0.5 per cent per annum. From 31 March 2012 promotional salary increases are assumed to apply only in respect of service after the date of promotion.

**28. Retirement benefit schemes** continued

	2012		2011	
	Males	Females	Males	Females
Average life expectancy for mortality tables used to determine defined benefit obligations:				
– Member aged 65 now (pension under £9,300 pa or pensionable pay under £35,000 pa)	20.5	22.4	19.8	21.7
– Member aged 65 now (others)	22.6	24.8	21.5	22.7
– Member aged 65 in 20 years' time (pension under £9,300 pa or pensionable pay under £35,000 pa)	22.8	24.9	22.2	23.2
– Member aged 65 in 20 years' time (others)	24.9	27.1	23.7	24.2

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

	2012 £m	2011 £m
Current service cost – defined contribution (see Note 6)	14	17
Current service cost – defined benefit (see Note 6)	119	131
Interest cost	150	165
Expected return on scheme assets	(147)	(138)
Past service cost	(74)	–
	62	175

During the year it was agreed that future pensionable pay increases on past service benefits in the Section will be capped at RPI plus 0.5% each year. In addition, promotional salary increases of 0.5% per annum are assumed to only apply in respect of service after the date of promotion. This has resulted in a past service cost adjustment, which is included in the Income statement.

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

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

	2012 £m	2011 £m
Loss/(gain) on defined benefit obligation	150	(509)
Loss/(gain) on scheme assets	95	(36)
Total loss/(gain) recognised in the statements of comprehensive income	245	(545)

The cumulative amount of actuarial losses recognised in other comprehensive income was £438m (2011: £193m).

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

	2012 £m	2011 £m
The defined benefit obligation is made up as follows:		
Active members	(3,002)	(2,793)
Deferred pensioner members	(375)	(316)
Retired members	(1,408)	(1,218)
Present value of defined benefit obligation	(4,785)	(4,327)
Fair value of scheme assets	3,683	3,519
<b>Deficit in the scheme</b>	<b>(1,102)</b>	<b>(808)</b>
<b>Company's share (60%) of the scheme deficit recognised in the Balance sheet</b>	<b>(661)</b>	<b>(485)</b>

This amount is presented as a non-current liability in the Balance sheet.

Cumulative gains or losses are recognised in equity.

## 28. Retirement benefit schemes *continued*

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

	2012 £m	2011 £m
At 1 April	(4,327)	(4,802)
Current service cost including members' share	(208)	(231)
Interest cost	(250)	(275)
Section amendment (past service cost adjustment)	123	–
Benefit payments	127	131
Actuarial gains and losses	(250)	850
<b>At 31 March</b>	<b>(4,785)</b>	<b>(4,327)</b>

Movements in the present value of fair value of retirement benefit scheme assets (including members' share) in the current year were as follows:

	2012 £m	2011 £m
At 1 April	3,519	3,160
Expected return on scheme assets	245	230
Actuarial gains and losses	(159)	60
Contributions from scheme members	74	70
Contributions from employer	131	130
Benefit payments	(127)	(131)
<b>At 31 March</b>	<b>3,683</b>	<b>3,519</b>

The actual return on scheme assets was £86m (2011: £290m).

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		Percentage of assets	
	2012 %	2011 %	2012 £m	2011 £m	2012 %	2011 %
Equity instruments	6.7	7.3	2,933	2,795	79.64	79.42
Debt instruments – Government	3.1	4.4	243	197	6.60	5.60
Debt instruments – Non-government	4.1	5.0	210	224	5.70	6.37
Property	6.3	6.0	277	298	7.52	8.47
Other	2.5	3.7	20	5	0.54	0.14
			<b>3,683</b>	<b>3,519</b>		

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

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

## 28. Retirement benefit schemes continued

### 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:

	2012 £m	2011 £m
<b>Discount rate</b>		
Change in defined benefit obligation at year end from a 25 basis points increase	<b>(201)</b>	(194)
Change in defined benefit obligation at year end from a 25 basis points decrease	<b>211</b>	204
<b>Mortality</b>		
Change in defined benefit obligation from a one year increase in longevity	<b>105</b>	106
Change in defined benefit obligation from a one year decrease in longevity	<b>(115)</b>	(111)

The history of experience adjustments is as follows:

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
Present value of defined benefit obligations	<b>(4,785)</b>	(4,327)	(4,802)	(3,317)	(3,572)
Fair value of scheme assets	<b>3,683</b>	3,519	3,160	2,211	2,955
Deficit in the scheme	<b>(1,102)</b>	(808)	(1,642)	(1,106)	(617)
Company's share (60 %) of the scheme deficit recognised in the Balance sheet	<b>(661)</b>	(485)	(985)	(664)	(370)

#### Experience adjustments on scheme liabilities

Amount (£m)	<b>(65)</b>	64	32	151	(114)
Percentage of scheme liabilities	<b>1.36%</b>	1.48%	0.67%	4.55%	3.19%

#### Experience adjustments on scheme assets

Amount (£m)	<b>(95)</b>	36	396	(631)	(222)
Percentage of scheme assets	<b>(2.58%)</b>	1.02%	12.53%	(28.54)%	(7.51)%

The estimated amounts of contributions expected to be paid by the Group and members to the scheme during the year ending 31 March 2013 are £125m and £67m, respectively.

## 29. Related party transactions

The Company considers its key management personnel to be its Directors. Details of their remuneration can be found in the Directors' remuneration report on pages 46 to 58.

## **Company information**

### **Calendar 2012/13**

31 March 2012	Year end
7 June 2012	Preliminary results announcement for full year to 31 March 2012
19 July 2012	Annual General Meeting of Network Rail Limited
November 2012	Results for half-year announcement to 30 September 2012
31 March 2013	Year end

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