Network Rail Infrastructure Limited
ANNUAL REPORT AND ACCOUNTS 2005

Company Number. 2904587

Network Rail

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Annual Report and Accounts 2005

Contents

Officers

Directors
John Armitt
David Bailey
Robert den Besten
Yvonne Constance
Jim Cornell
Iain Coucher
Michael Firth
Peter Henderson
Ron Henderson
Charles Hoppe
Ian McAllister
Ross Sayers

Secretary
Hazel Walker

Overview

17%

reduction in Network Rail train delays

83.6%

of trains arriving on time

4.2%

increase in gross freight tonne miles

626

miles of new rail laid

15,062

maintenance workers transferred into the Company

3.6%

reduction in broken rails – now at lowest level ever recorded

Financial highlights

	2005 £m	2004 £m
Turnover	**3,800**	2,606
Operating profit/(loss) before exceptional items of £53m (2004: £157m)	**460**	(601)
Operating profit/(loss) after exceptional items	**407**	(758)
Net interest payable	**(640)**	(352)
Loss before taxation	**(164)**	(1,070)
Net cash inflow from operating activities	**980**	1,078
Net debt	**(15,646)**	(12,600)
Railway network fixed assets	**23,011**	18,498
Net assets	**5,217**	3,592
Capital expenditure	**3,598**	3,858
Maintenance expenditure	**1,402**	1,408

Chairman's statement

The last year has seen accelerating improvements in the performance and efficiency of the rail infrastructure.

When Network Rail was created in October 2002 we said it would take three to five years to deliver the transformation in the performance and efficiency of the railway that the country wished to see. Two-and-a-half years on I am delighted to report that substantial improvement has been made and that the advances have not only continued but are accelerating.

During 2004/05, delays caused by the rail infrastructure reduced by 2.3m minutes, coming down from 13.7m to 11.4m minutes. This 17% reduction means the target set by the Office of Rail Regulation (ORR) has been exceeded by nearly 900,000 minutes. The achievement in bringing down delays is a tremendous accomplishment of which everyone in Network Rail is justly proud. When combined with the improvements delivered by the train operators, this delay reduction has meant that, over the year 83.6% of trains have run on time, compared to 81.2% during 2003/04.

A large number of initiatives have contributed to this notable improvement. The ground-breaking decision to bring rail maintenance in-house and the introduction of integrated control centres with train operators are worthy of specific mention. Both of these changes have streamlined day-to-day decision-making in the interests of passengers. In addition, the record investment in the rail infrastructure, with nearly double the rate of track renewals compared to five years ago, is contributing to a significant reduction in the number of infrastructure failures across the network.

Along with the marked improvement in train performance, the year has also seen a significant improvement in our efficiency and financial results. During the year we made significant efficiency savings against the ORR determination which contributed to a return to operating profit.

Improvements on freight routes in recent years have been a major factor in the growth of freight on the rail network. A key example is the successful completion of the upgrade of the Felixstowe to Nuneaton line. Today, larger 9'6" freight containers can now travel from Felixstowe to the Midlands, encouraging the growth of the freight market and reducing the amount of lorries on Britain's busy roads. The positive effect of these projects is demonstrated by an increase of over 4% in gross tonne miles in the last year.

The railway continues to be a very safe method of travel. Most safety risk indicators remain at historically low levels. Broken rails, for instance, have declined to their lowest level ever recorded whilst, following the completion of the installation of the Train Protection and Warning System, the risk from Signals Passed at Danger has more than halved in the last two years.

Regrettably, the continuing good safety record was overshadowed by the accident at Ufton Nervet in Berkshire on 6 November 2004 in which seven people were killed. Our thoughts remain with the families of the bereaved and those injured. The Health and Safety Executive carried out a full investigation immediately after the accident and came to the conclusion that there was no failure of the railway connected to the accident.

We also deeply regret that during the year four railway employees were killed at work. Recent years have seen several workforce fatalities each year. Whilst this was a reduction on the previous year, we remain committed to improving the culture and processes of the Company to minimise risk to employees.

One achievement in which we took great pride was the new timetable on the West Coast mainline which came into effect in September. The combination of the new infrastructure and the tilting trains reduced the journey time from London to Manchester by some 35 minutes. The focus of work on the West Coast upgrade has now moved north of Manchester where we are continuing to deliver incremental journey time improvements.

In July 2004, the Secretary of State for Transport published a White Paper "The Future of Rail". The White Paper signalled the Government's intention to abolish the Strategic Rail Authority and transfer to Network Rail the responsibility for both route planning and accounting for industry performance. The Company is pleased to take on these new responsibilities on behalf of the industry and has been working with the Department for Transport over recent months to implement the White Paper in full.

Network Rail's relationship with its Members has continued to develop during the course of the last year. In addition to two national meetings we also meet Members on a route-by-route basis to consider local issues affecting the railway. In total, 16 of these route-based meetings have been held in the last year.

A number of changes have taken place at Board level with the departures of Deputy Chairman, Adrian Montague, and Director of Safety and Compliance, Chris Leah. Adrian is pursuing his other roles, including being Chairman of British Energy, and Chris has retired after 38 years in the rail industry. Both Adrian and Chris made an enormous contribution to Network Rail and the Board would like to extend our sincere thanks for their work. In addition, Michael Firth and Yvonne Constance have joined the Board as Non-Executive Directors. In June 2005, Chris Green will also be joining us as a further Non-Executive Director. Michael, Yvonne and Chris bring significant experience to the already strong team at Board level.

The last year has been a successful one. The improvement which began during the previous year, has been sustained and is accelerating. For 19 successive months we have witnessed year-on-year improvements in delays attributed to Network Rail and the bar has been raised with even tougher targets introduced for the future. On efficiency, real savings are now coming through as we work to make the railway more cost effective. In the year to come our objective is to build on these improvements – maintaining the good safety record, making the railway more efficient and making trains more punctual.

Ian McAllister
Chairman
26 May 2005

Chief Executive's review

During the last year, Network Rail's 30,000 employees have taken considerable strides towards our objective of delivering a safe, reliable and efficient railway. Moreover, the year has seen the improvements which began during the previous year continue and accelerate.

Performance

Network Rail's contribution to the overall punctuality of trains is measured by infrastructure delay minutes. It is on this basis that the ORR sets the Company its targets. In the last year, infrastructure delay minutes fell by nearly 2.3m minutes, from 13.7m minutes to 11.4m minutes. This 17% reduction in delays is an excellent achievement and means that the target set by the ORR has been beaten by some nearly 900,000 minutes.

The Company is ambitious for Britain's railway and is therefore raising the bar on train punctuality by making our targets for each of the next four years even tougher. With the new targets, Network Rail aims to deliver additional reductions in delays each year, every year for the next four years. In total, the Company intends to cut passenger delays by an extra 3.6m minutes over and above the already demanding targets set by the ORR.

Combined with the improvements in performance made by the train operators, this substantial reduction in Network Rail infrastructure delays has led to an increase in the proportion of trains classified as arriving "on-time" on a moving annual average basis from 81.2% during the previous year to 83.6%. By the end of next summer, we anticipate that this measure will exceed the 86.1% level seen before the Hatfield accident.

A large number of specific initiatives have contributed to the improving rail performance passengers are currently enjoying.

First, the ground-breaking decision to bring rail maintenance in-house was fully implemented by July 2004 and there is already considerable evidence to suggest it has made a significant contribution to reducing delays. Most encouragingly, the areas in which maintenance came in-house first have seen the most marked improvements, suggesting further reductions in delays can be achieved in the years ahead.

The ever closer on the ground partnerships between Network Rail and train operators are delivering significant benefits for train punctuality. In seven locations around the country integrated control centres have been created. This allows Network Rail and train operator employees to work alongside each other to deliver more streamlined operational decision-making. At Waterloo, where the integrated control centre was opened in February 2004, the first year of its operation saw a 30% reduction in delays per incident – the measure which is most impacted by the speed of decision-making. Over the year to come, Network Rail intends to extend the integrated control centre model out to the routes which currently do not benefit from this important innovation which benefits passengers.

Further progress is being made in making the railway a more attractive option for the freight market, building on the growth of recent years including a 4.2% increase in gross tonne miles in the last year. A significant development for freight was the completion of the Felixstowe to Nuneaton project that has been completed on time and within budget, allowing larger containers access to the network from the ports of Felixstowe, Harwich and Tilbury.

The rail freight industry is constantly developing with new sites connected to the network, including terminals at Greenburn for coal, Lincoln and Bradford (scrap), and Hitchin, Harlow Mill and Chesterton (aggregates).

A priority area for improvement in the coming year is the advance notification of engineering works. This has been a problem for the industry for several years and Network Rail has agreed a recovery plan with the ORR which will involve us, by September, agreeing a fixed timetable with passenger and freight operators no less than 12 weeks before the date of travel. This will allow passengers a better opportunity to book their journeys in advance and also take advantage of any discounted ticket offers which may subsequently be made available by operators.

Cost control

It was clear when Network Rail was created that the long-term sustainability of the railway required the Company to bring down the costs of operating and maintaining the infrastructure which had escalated significantly in the years before our stewardship of the network commenced.

In the last year we have made substantial progress in this regard, with significant efficiency savings having been made. In order to meet the ORR's demanding 31% five-year efficiency target, further efficiencies will have to be made during each of the four remaining years of the Regulatory Control Period.

These efficiency savings, along with the commencement of the new Control Period, have contributed to an improved set of financial results. The Group Finance Director has set out the principal factors which have delivered this financial progress in his review of the year, but clearly it can only be very good news for the long-term health of the business and the railway as a whole.

The increasing quality of our knowledge of our infrastructure, including the introduction of the MIMS (Maintenance Information Management System) asset register, allowed us to defer significant amounts of renewals and enhancement activity last year. Most of this work will still be carried out during this Control Period, but we have taken the positive decision to defer the work based either on our improved understanding of the infrastructure or on our determination to achieve the right specification. When the work is carried out we believe that in many cases better value for money and better technical solutions can be found as a result of the deferment.

Overall, the improved financial efficiency of Network Rail has meant we have exceeded our target for the last year.

Safety

As the Chairman mentioned in his statement, another year of strong safety performance was sadly overshadowed by the very tragic accident at Ufton Nervet in Berkshire as well as a number of workforce fatalities.

The Ufton Nervet accident, in November 2004, occurred when a First Great Western train struck a motor vehicle at a level crossing causing the derailment of the train and seven fatalities. The Health and Safety Executive carried out a full investigation immediately after the accident and came to the conclusion that there was no failure of the railway connected to the accident. Such accidents touch everyone in Network Rail very deeply indeed and our thoughts remain with the bereaved and those injured.

There were four railway employee fatalities last year. Workforce safety is a matter of utmost importance to the Board and we will continue to work to enhance the culture and processes of Network Rail to minimise risk to all those working on the railway.

Overall, however, the safety performance of the railway remains good when compared either internationally or to other modes of transport. Broken rails fell from 334 the previous year to 322 in 2004/05 – the lowest level ever recorded. Given that only five years ago broken rails stood at more than 900 per annum, this is a substantial achievement.

The risk from trains passing red signals has also fallen dramatically following the introduction of the Train Protection and Warning System (TPWS). In the year to come, we will begin to introduce TPWS+, which enhances the safety benefits of TPWS for faster trains, at key locations across the network. TPWS+ should allow us to reduce risk from trains passing red signals still further.

Asset condition

The rebuilding of the railway saw continuing record levels of investment to improve the infrastructure.

Amongst the outputs from the substantial expenditure on railway engineering works last year were the laying of 626 miles of new rail, 511 units of switches and crossings, and 450 miles of ballast.

These renewals volumes are contributing significantly to reductions in infrastructure failures which in turn feed through directly to fewer delays to passengers. Track circuit failures, for instance, fell 7%, whilst points failures came down 11%.

The improving condition of the railway asset has resulted in a substantial improvement in Network Rail's Asset Stewardship Index with the target having been exceeded. As with delay minutes, we have responded to this by deciding to raise the bar on asset condition and make the targets for the future even tougher than those originally set by the ORR.

Projects

At any one time, Network Rail is delivering a number of large projects which are critical for the future and growth of the railway. This year has been no different.

The largest project we are managing is the upgrade of the West Coast mainline which is already delivering significant benefits to passengers and freight users alike. The new timetable introduced in September has reduced the journey time from London to Manchester by some 35 minutes and further incremental journey time improvements will be delivered by a large volume of works between Manchester and Glasgow in the coming year. In addition, the Trent Valley section of the West Coast mainline is to be doubled from two to four tracks, removing a key bottleneck and allowing improved services.

The implementation of the Cullen Inquiry recommendation to introduce nationwide secure train cab to signaller communications has moved on significantly in the last year. The GSM-R system requires the erection of 2,000 masts over the country. Network Rail is acutely aware that radio masts are not always popular in local communities and we continue to work to position masts as sensitively as possible and inform local residents where appropriate as we implement this mandatory safety system.

The Thameslink Programme to upgrade this vital north-south artery through London has made good progress with the submission of the new planning applications relating to Blackfriars station, Borough Market and London Bridge station. The applications have been referred to a new Public Inquiry to commence in September 2005.

Pleasingly, the Government has given the go ahead for the expansion of King's Cross station, with the construction of a new Western Concourse and the restoration of the original Grade One listed façade at the front of the station. In addition, plans to upgrade Birmingham New Street and Edinburgh Waverley mean there is now in the pipeline a substantial body of improvements to some of the busiest stations on the network.

Finally, the project to upgrade the power supply in the South-East of England to facilitate the introduction of some 2,000 new train vehicles is nearing completion. The project will cost £650m against original estimates of £1bn. Over 1,800 of the new vehicles are now operating on the network and "slam-door" trains will be removed by the end of 2005.

Implementing the White Paper

Important structural changes to the rail industry were announced by the Government with the publication of the White Paper, "The Future of Rail", in July 2004.

The White Paper announced the abolition of the Strategic Rail Authority (SRA), the transfer of significant new responsibilities to Network Rail and the creation of opportunities for better cross-working between Network Rail and train operators. Network Rail welcomed the White Paper and continues to work with the Department for Transport, the SRA, the ORR, the train operators and the rest of the industry to help deliver the changes as quickly and seamlessly as possible. An important milestone in this regard was reached in April 2005 with the Railways Act receiving Royal Assent and passing into law.

One of Network Rail's new responsibilities is to produce, on behalf of the industry, Route Utilisation Strategies (RUS) for each part of the network. The Company is moving forward with the development of the RUS process and is committed to an inclusive process, with a high degree of involvement from train operators and other stakeholders.

Outlook

Considerable progress has been made in the last year. Network Rail has accelerated the improvements being delivered on Britain's railway, with a very substantial 2.3m minute cut in delays and significant improvements in efficiency. We are ambitious for the railway and have raised the bar on train punctuality by making future targets even tougher.

The year to come will see Network Rail's employees continue to work hard to meet our objectives as we target a further substantial reduction in delays and further efficiency savings. The rebuilding of the railway goes on, the progress is good and passengers are now seeing real benefits. We are determined to deliver further improvements.

John Armitt
Chief Executive
26 May 2005

Group Finance Director's review

The year ended 31 March 2005 has been another year of substantial progress. Following the determination from the Office of Rail Regulation (ORR) on our expenditure needs for the five-year period from 1 April 2004, the Company has been able to look to its financial future with confidence. Now that our medium-term financial footing is secure, both in terms of knowing what we are expected to deliver, and at what cost, we can now concentrate entirely on delivering our requirements as efficiently as possible within an environment of strong budgetary and financial control.

The challenge of meeting our efficiency targets set by the ORR has been our key focus. Savings have been delivered by focusing on strong budgetary control at all times and a conscious drive to minimise spend in specific areas such as consultancy and agency staff. Further efficiencies will need to be delivered for the remainder of the control period in order to meet fully the ORR challenge.

In terms of maintenance we have made good progress in delivering efficiencies. We continue to develop our understanding of our cost drivers and have made substantial further progress towards achieving a meaningful unit costing structure for maintenance work. The bringing in-house of maintenance has been a success on both operational and financial fronts. The costs of completing this exercise, and indeed the total costs of the functional reorganisation were expected to be in the region of £200m but in the event we have incurred exceptional charges of £158m, of which the final £53m was incurred this year.

Our approach to investment is built on the foundations of strong budgetary control and detailed value analysis. Maximising the value of the pound in the ground underpins all our investment appraisal and planning and we continue to seek increased value from our investment expenditure. This has led to what may look like a slow start towards meeting the ORR determination in terms of renewals and enhancements but we make no apology for delaying spend to optimise efficiency. This year has seen major efficiencies delivered on the Southern Power Supply Upgrade and other savings elsewhere. Our recently published business plan underlines our intention to deliver the ORR five-year targets which will continue the unprecedented levels of investment in the network.

The West Coast Route Modernisation (WCRM) project has continued to deliver its outputs on time, with key stages met in September 2004 and others on course for June and December 2005. We continue to face up to the efficiency challenge set by ORR, although the efficiencies required are yet to be identified fully.

The Company's network fixed assets have continued to grow reflecting the unprecedented levels of investment in the railway. The ORR's statement of 27 June 2002 whereby all expenditure above the ORR determination in the years ended 31 March 2003 and 2004 was added to the RAB does not apply to later years and all additional expenditure above that assumed by the ORR in the new determination is now only included in the RAB where it represents a clear investment or where it arises from new obligations. In addition the Company has recorded a revaluation to network fixed assets of £1.7bn, reflecting the economic value of the revenue grant deferred during the year, which will be received from 2006/07 onwards. The total increase in the carrying value of the Railway Network in 2004/05 is £4.5bn, from £18.5bn to £23.0bn.

The last 12 months have seen the Company record an operating profit of £407m. This compares to an operating loss of £758m recorded in the previous year. This significant improvement is a testament to our strong budgetary control and detailed focus on cost drivers and value for money. It also reflects significantly improved train performance which, aided by the interim review recalibration, has seen us turn performance penalties of £348m in 2003/04 into performance income of £102m in the current year. There has been no write-off of Network Grant during the year (whereas £544m was written off in 2003/04). This operating profit has been achieved whilst deferring £1.7bn of Network Grant to future years as agreed following the new ORR determination. This deferral will be replicated in the current year. In addition, in the year under review the Company rebated £250m of fixed track access income to train operating companies matching an identical sum of Network Grant. We are particularly pleased that under such constraints we have continued to meet our debt to RAB licence condition ratio which stood at 77% at 31 March 2005.

The issue of FRS 17 pensions deficits is one that many companies will face this year. Network Rail continues to account for pensions under SSAP 24, and the accounting estimate of the Company's share of the FRS 17 shortfall of the Network Rail section of the Railway Pension Scheme (RPS) disclosed in the notes to these financial statements is some £410m. This reflects the poor performance of the markets and the increased life expectancy of pension scheme members. The Company will be assessing with the scheme trustee the implications of such a deficit later this year but it is important to note that the funding deficit of the scheme is likely to be much lower than the accounting deficit owing to the prudent assumptions on the discount rate applied to liabilities that FRS 17 dictates.

Financial performance

- turnover was £3,800m, an increase of £1,194m against prior year turnover of £2,606m. The increase was a result of higher Network Grant income for the year partially offset by a decrease

Group Finance Director's review

in fixed track access charges following the ORR determination. In addition, turnover was reduced in the prior year by an agreed grant write-off of £544m. The overall swing of £450m in respect of performance has also improved net turnover;

- operating costs totalled £3,393m, an increase of £29m on prior year costs of £3,364m. This is the increase in nominal terms before allowing for inflation and has been contained at this level despite an increase of £50m in pension costs and additional depreciation, which rose to £834m from £695m;
- profits of £69m were achieved from the sale of properties (2003/04: £40m);
- interest charges have increased to £640m from £352m reflecting the increased levels of debt in the group, mainly as a result of the deferral of income outlined above;
- net debt increased from £12.6bn to £15.6bn in the year;
- total fixed assets have increased from £18.7bn to £23.2bn;
- net assets at 31 March 2005 totalled £5.22bn (31 March 2004: £3.59bn).

Exceptional items

As outlined above exceptional charges for the year totalled £53m. These related to further costs of the functional reorganisation, for which £105m was charged in 2003-04.

Taxation

The Company recorded a taxation credit for the year of £30m compared to a credit of £336m last year.

Cash flow

- during the year the Company's operating activities generated cash of £980m (2003/04: £1,078m). Net interest paid amounted to £475m (2003/04: £421m);
- spending on fixed assets totalled £3.5bn (2003/04: £3.8bn) while receipts from fixed asset sales and capital grants contributed £0.07bn (2003/04: £0.04bn).

Changes in funding

The year ended 31 March 2005 saw the highly successful launch of Network Rail's Debt Issuance Programme ("DIP") through a special purpose financing company Network Rail Infrastructure Finance PLC ("NRIF").

NRIF was incorporated for the sole purpose of acting as the issuer under the DIP and is not a member of the Network Rail group or related to or controlled by the Strategic Rail Authority (SRA). For accounting purposes NRIF is treated as a quasi-subsidiary in the consolidated accounts of Network Rail Infrastructure Limited ("NRIL").

The launch of the DIP marked a major milestone in the development of Network Rail's finances and allows access, through a single platform, to the widest possible sources of funding including the long-term capital markets. Giving Network Rail access to the widest possible sources of funding at the lowest possible cost will provide a stable base for funding a continuing programme of long-term investment in the national rail network.

Within the DIP is a £20bn note programme which has been highly rated (AAA by Standard and Poors, Aaa by Moody's and AAA by Fitch). The programme also benefits from a £3.5bn working capital facility.

The DIP is supported by a financial indemnity from the SRA which expires in 2052. The SRA, in turn, benefit from a Letter of Comfort from the Secretary of State for Transport. The Railways Act was passed on 7 April 2005 and following due process and time, the obligation will pass from the SRA to the Secretary of State for Transport.

Since commencement of trading £3.6bn of debt has been raised, the majority being fixed rate sterling and index linked sterling bonds. All non-sterling issuance under the programme was swapped into fixed sterling interest rates as at the balance sheet date to protect against movements in interest and foreign exchange rates.

Additional borrowing requirements have been met through the DIP and an additional US dollar bond of £276m issued under the Medium Term Note Programme. The launch of the DIP facilitated the final repayment of amounts outstanding under the Bridge bank facility during the year.

The Company had £7.4bn of undrawn committed facilities available at 31 March 2005 through the DIP working capital facility and the SRA standby facility A. The SRA standby facility is undrawn but will only be called upon as a last resort.

Accounting policies

There have been no changes to accounting policies in the year.

International accounting standards

European Union regulations require listed companies in any member state to adopt International Financial Reporting Standards (IFRS) for financial years commencing on or after 1 January 2005. The Company has a regulatory requirement to report in the manner of a listed PLC and therefore must comply with IFRS for the year ended 31 March 2006.

The Company has been running a project during the year to ensure full compliance is achieved. At the time of writing we are pleased to report that the Company has completed this project and has been able to restate its UK GAAP balance sheet at 31 March 2004. The restatement of the 31 March 2005 balance sheet and profit and loss for the year then ended is also substantially complete. These restated balance sheets and profit and loss account will be presented to our Members and published on the Company website in August 2005, prior to the issue of our interim financial results for the six months ended 30 September 2005.

The major areas of the balance sheet affected by the transition to IFRS are as follows:

Investment properties and fixed assets

IAS 40 "Investment Properties" significantly widens the definition of an investment property. The standard states that an investment property is land and/or a building or part of a building, held to earn rentals and/or for capital appreciation. For Network Rail IAS 40 applies to the majority of the Spacia estate and a number of serviced offices. This will require a £725m reclassification from network fixed assets to investment properties as at 1 April 2004. Assets will be reclassified to investment properties at the same value that they were held within network fixed assets. Under IAS 40 movements in the fair value of investment properties will be recorded through the income statement whereas currently under UK GAAP movements are taken through the revaluation reserve.

Pensions

Network Rail currently accounts for pensions in accordance with SSAP 24, which spreads the costs of providing benefits over the average service lives of the employees. Additional disclosures required by FRS 17 detail the scheme deficit. IAS 19 "Employee benefits" (the IFRS for pensions) takes a similar valuation approach to FRS 17 and in accordance with the transitional requirements of IFRS the Company's share of the full pension deficit will be recognised on the balance sheet at the transition date of 1 April 2004. Actuarial gains and losses in subsequent years will be recognised immediately in the balance sheet through the statement of recognised income and expense, outside the income statement. This treatment was confirmed following the amendment to IAS 19 published by the IASB in December 2004, which is expected to be endorsed by the EU later this year. The IFRS balance sheet will therefore reflect the full deficit position of the scheme.

Financial instruments

The Company will adopt IAS 39 in full from 1 April 2005, having taken the allowed exemption to ignore accounting for derivatives and hedges at fair value in the opening IFRS year. Adoption of IAS 39 in full will result in recognition of derivative balances on the balance sheet at fair value. Movements in fair value on instruments that qualify for cash flow hedge accounting under IAS 39 will be recognised directly in equity to the extent the hedging is effective. Instruments not qualifying for hedge accounting and ineffective portions of hedge relationships will be recorded in the income statement.

Deferred taxation

Significant additional deferred taxation provisions are required under IFRS, principally due to the tax treatment of the revaluation of the railway network. Under IAS 12, deferred taxation is provided in full on temporary differences arising between the tax bases of assets and liabilities and their carrying value in the financial statements. The additional deferred taxation provision will be treated principally as a reduction in the revaluation reserve.

Net assets

The effect of restating the balance sheet at 31 March 2004 under IFRS will be to reduce net assets by approximately £1.0bn.

Treasury operations

The Group's treasury operations are co-ordinated and managed in accordance with policies and procedures approved by the Board. Treasury is subject to regular internal audits and does not engage in trades of a speculative nature.

An annual funding plan approved by the Board sets out in detail the Group's 12 months' financing requirements and in broad terms the requirement for the next five years. It explains the options available together with their strengths and weaknesses and a recommended strategy. Group policy is to ensure that there are sufficient committed bank facilities and short-term investments to cover, as a minimum, the next 12 months' funding requirements.

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

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

The Group's primary liquidity is provided by committed bank facilities. At 31 March 2005, the Group had £7.4bn in undrawn committed facilities.

Summary

This has been a year that has given us a great deal of encouragement as we begin to see the benefits of doing the right things in the proper way. The focus on strong budgetary control has resulted in savings being delivered and close control of spend has led to net debt being much lower than anticipated as we seek to deliver tangible value-for-money improvements. We are confident that continuing to build upon this will give us not only a financial rigour that can be relied upon but also a railway of which we can be proud.

Ronald Henderson

Ron Henderson
Group Finance Director
26 May 2005

Directors' report

Under its network licence the Company is required to publish such information as would be required if it were a listed company and comply with the principles of good governance and code of best practice under, or approved for the purposes of, the listing rules of the Financial Services Authority. As such, it is publishing this Report and audited Accounts.

Principal activities

Network Rail Infrastructure Limited is responsible for the management of the national rail infrastructure. Its principal activities are:

- providing train operators with railway track access;
- managing train timetabling, train planning and signalling;
- maintaining and renewing the infrastructure and undertaking major capital programmes.

Business review

31 March 2004
Network Rail Infrastructure Finance PLC (NRIF) was formed as a special purpose business outside the Network Rail Group for issuing a £20bn multicurrency note issuance programme with a £3.5bn 364-day revolving credit facility. The proceeds of issuance made under this programme are being used to fund the Company's activities including re-financing of existing debt of the Network Rail Group.

July 2004
Taking the maintenance activity in-house was successfully completed on schedule. Over nine months, 15,000 people were transferred into the Company from seven different maintenance contractors.

The Government published its White Paper "The Future of Rail" in July 2004 proposing a number of significant changes to the structure and organisation of the railway. These proposals give Network Rail additional responsibilities for industry performance, planning and projects.

The changes are designed to deliver improvements in reliability and the effectiveness of industry planning, building on the already close collaboration between Network Rail and train operators. Some of the changes involving Network Rail have already been implemented and significant progress has been made in other areas. This process is expected to be completed around the end of 2005.

October 2004
Launch of the listed debt programme in NRIF.

Significant events subsequent to 31 March 2005

7 April 2005
The Railways Act 2005 was passed by Parliament facilitating various aspects of the changes proposed under the White Paper.

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

Results

The loss before tax and exceptional items was £111m (2003/04: loss of £913m) and the loss after tax including exceptional items was £134m (2003/04: loss of £734m).

Share capital

50,084,937 ordinary shares of 0.1p and 160,000,000 redeemable shares of £1 of the Company are held by its immediate parent company Network Rail Holdco Limited.

Health and safety

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

Previous incidents

In July 2003, charges were laid against Railtrack plc (now being the Company) and one former and one then current director and four senior managers in relation to the Hatfield derailment of October 2000. In September 2004 charges against the directors, one senior manager and the manslaughter charges against Railtrack were dismissed. The trial in respect of the other senior managers (and Railtrack in respect of the remaining health and safety charge) commenced in January 2005 and is currently ongoing. The accidents that took place at Ladbroke Grove in October 1999 and Potters Bar in May 2002 are the subject of continuing police and/or Health and Safety Executive investigations, the outcomes of which are unknown at present.

Corporate social responsibility

Network Rail is committed to carrying out its activities in a socially responsible manner in respect of customers, stakeholders, employees and local communities. As part of its objective of operating in a transparent and accountable environment, a report on these aspects within its business is currently being prepared and is due to be published shortly.

Code of Business Conduct

The Company has adopted a Code of Business Conduct that is applicable to all employees.

Research and development

During the year the Group charged to the profit and loss account £3m (2003/04: £2m) on research and development. Other costs relating to significant development work have been capitalised in tangible fixed assets.

Directors and their interests

The present Directors and brief biographical details can be found on page 15.

The Directors of the Company were appointed on the following dates:

Current Directors

Name	Position	Date of first appointment	Next re-election
Ian McAllister	Chairman	3 October 2002	July 2006
John Armitt	Chief Executive	14 December 2001	July 2006
Iain Coucher	Deputy Chief Executive	3 October 2002	July 2006
Peter Henderson	Projects & Engineering Director	3 October 2002	July 2007
Ron Henderson	Group Finance Director	3 October 2002	July 2005
David Bailey	Non-Executive Director	3 October 2002	N/A*
Robert den Besten	Non-Executive Director	24 September 2003	July 2007
Yvonne Constance	Non-Executive Director	1 May 2005	July 2005
Jim Cornell	Non-Executive Director	14 December 2001	July 2006
Michael Firth	Non-Executive Director	4 December 2004	July 2005
Charles Hoppe	Non-Executive Director	3 October 2002	July 2005
Ross Sayers	Non-Executive Director	3 October 2002	July 2007

* As the Special Director David Bailey has not been not required to retire by rotation.

Other Directors who served in the year to 31 March 2005

Name	Date first appointment	Date of resignation
Chris Leah	5 October 1998	3 December 2004
Adrian Montague	3 October 2002	4 December 2004

There were no other changes to the Board during the year.

Michael Firth and Yvonne Constance were appointed to the Board as Non-Executive Directors on 4 December 2004 and 1 May 2005 respectively. Under the Articles of Association of the Company the Directors are not subject to retirement by rotation (as required under the Code), due to it being a wholly-owned subsidiary of Network Rail Limited. Under the provisions of the Articles of Association of Network Rail Limited, however, all Directors, save the Special Director, must retire by rotation, and may stand (together with any new Director appointed since the last general meeting) for re-election by the Members of the Company at least every three years. In common with the other members of the Board, Michael Firth and Yvonne Constance are also Directors of Network Rail Limited and so in line with this requirement they will be seeking election by the Members of Network Rail Limited at the 2005 AGM.

Directors' report

In addition, following announcement on 19 May 2005 of his forthcoming appointment as Non-Executive Director with effect on 26 June 2005, Christopher Green will be seeking election at the 2005 AGM. Also, on 26 June 2005, David Bailey's position will convert from that of Special Director to that of Non-Executive Director and as such he will seek election at this AGM.

Directors' interests

The Directors have no interests in the shares of the Company or any other Group company.

Shareholder details

The Company is a wholly-owned subsidiary of Network Rail Holdco Limited (itself a wholly-owned subsidiary of Network Rail Limited).

Equal opportunities and employee involvement

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

A third survey of employee engagement within the Group was conducted by the Gallup organisation and involved the response by employees to a questionnaire in December 2004 following the first survey conducted in February and March 2003 and the second survey conducted in December 2003.

The results of this latest survey showed improvement in employee engagement against the first and second results. Further improvement is now being sought with a programme of communication of the results of the survey together with training and action plans to increase employee engagement. A fourth survey is scheduled to be conducted later in the year with further surveys planned for subsequent years to monitor progress.

Effective communication with employees is also important. The Group uses a wide range of communications media, encompassing local information cascades and briefings, videos, the Company newspaper, email news bulletins, electronic data links and roadshows by the Directors to reach all our employees. Consultation on issues affecting the workforce also takes place at regular intervals through both national and local procedures with representatives from the Company and trades unions.

Our equal opportunities policy is communicated to employees. We are committed to offering our employees a fulfilling and challenging career in an environment free from discrimination, harassment, victimisation and bullying. The Company will continue to work with trades unions in the area of equality of opportunity and development of policy to promote best practice within the business. It is also a member of the Employers' Forums on Age and Disability.

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

Contributions for political and charitable purposes

During the year the Company donated £448,000 to charitable organisations (2003/04: £617,000). A further £639,000 (2003/04: £361,000) was used to sponsor charitable and community-related activities. No political donations were made in either year. These contributions include a total of £500,000 originally accrued and disclosed in 2003/04 but not incurred until the current year. The comparatives have been adjusted accordingly.

At the Annual General Meeting (AGM) of Network Rail Limited (being the ultimate parent of the Company) in 2004 Members gave authority for the Group to incur political expenditure and make political donations up to a maximum aggregate sum of £400,000 as a precautionary measure in light of the wide definition in The Political Parties, Elections and Referendums Act 2000. These authorities have only been used to support Network Rail's programme of work with all types of community representatives. This includes the significant amount of contact the Company has with a wide range of elected representatives (Members of Parliament, Members of the Scottish Parliament, members of the Greater London Authority, members of the Welsh Assembly, Regional Assemblies, Local Councils and others) as well as non-governmental organisations, pressure groups and campaigning organisations. This programme includes meetings to discuss issues facing the Company and those using the railways, both passengers and freight customers nationally and regionally. We also take the opportunity each year to explain to elected representatives our business plans, the Company's performance and significant developments within the business.

Creditors payment policy

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

At 31 March 2005 the Group's creditor days compared with the value of suppliers' invoices received in the year was 59 days (2003/04: 31).

Annual General Meeting

Network Rail Limited, as the ultimate parent company of Network Rail Infrastructure Limited, will be holding its Annual General Meeting on 20 July 2005. Notice of that meeting will be sent to Members.

Auditors

At the Annual General Meeting of Network Rail Limited, which will be held on 20 July 2005, a resolution will be proposed to re-appoint Deloitte & Touche LLP as the Group's auditors and to authorise the Directors to fix their remuneration. Details of the fees earned by Deloitte & Touche LLP during the period, for both audit and non-audit work, are set out in note 5 on page 38.

By order of the Board

Hazel Walker
Secretary
26 May 2005

Board of Directors

First row from left: Ian McAllister, John Armitt, Iain Coucher, Ron Henderson
Second row from left: Peter Henderson, Ross Sayers, David Bailey, Robert den Besten
Third row from left: Yvonne Constance, Jim Cornell, Michael Firth, Christopher Green (appointment effective on 26 June 2005)
Fourth row from left: Charles Hoppe

John Armitt CBE

Chief Executive (3, 5, 6 & 7)*

John Armitt, 59, is the Chief Executive of Network Rail. A civil engineer by training, he was previously Chief Executive of Costain Group PLC, and before that Chief Executive of Union Railways.

David Bailey OBE

Non-Executive Director (1, 2, 4 & 6)*

David Bailey, 65, has been the Strategic Rail Authority's Non-Executive Director on the Network Rail Board. He was formerly Commercial Director for London Transport, having previously held various director-level roles within London Underground.

Robert den Besten

Non-Executive Director (1 & 2)*

Robert den Besten, 64, joined the Board on 24 September 2003 having previously been President and Chief Executive Officer of Netherlands Railways, President and CEO of Amsterdam Airport Schiphol, Permanent Secretary of the Ministry of Transport and Public Works and Managing Director of the Rotterdam Municipal Transport Corporation.

Yvonne Constance OBE

Non-Executive Director (2)*

Yvonne Constance, 62, joined the Board on 1 May 2005 having previously been Chairman of the National Electricity Consumers' Council between 1995 and 1999, a Non-Executive Director of Innogy plc from 2000 to 2002 and a Non-Executive Director of St Mary's Hospital NHS Trust. Since 2000 she has also been a member of the Greater London Magistrates' Courts' Authority, as well as being a Justice of the Peace since 1976 and, in the 1980s, practised as a barrister.

Jim Cornell

Non-Executive Director (2, 4 & 6)*

Jim Cornell, 65, joined British Rail (BR) in 1959 as a student civil engineer before taking up various positions in BR including latterly Group Managing Director of British Rail Infrastructure Services between 1993 and 1996. He is also Executive Director of the Railway Heritage Trust.

Iain Coucher

Deputy Chief Executive (3 & 5)*

Iain Coucher, 43, is Deputy Chief Executive with responsibility for operational matters. Previously, he was Chief Executive of Tube Lines. For 16 years, he worked for EDS and for three years was seconded to TranSys as Chief Executive.

Michael Firth

Non-Executive Director (1, 2 & 7) *

Michael Firth 62, joined the Board on 4 December 2004 having previously been Head of Corporate Banking at HSBC Bank plc until his retirement in September 2002. He is now a Non-Executive Director of Somerfield plc and also of Communisis plc and First Technology PLC.

Christopher Green

Non-Executive Director (with effect on 26 June 2005) (2)*

Christopher Green, 61, will join the Board with effect on 26 June 2005 following his retirement as Chairman of Virgin Rail Group. Having joined British Rail upon leaving university Christopher held various management positions including Managing Director of Intercity. He was Chief Executive of Virgin Trains from 1999 to 2004.

Peter Henderson

Projects and Engineering Director (3 & 5)*

Peter Henderson, 51, is Network Rail's Projects and Engineering Director. Peter has over 20 years' rail experience, most recently at Bechtel where he was Projects Director, Rail, which included responsibility for engineering. He spent 16 years with the Hong Kong Mass Transit Railway Corporation, latterly as Head of Major Projects.

Ron Henderson

Group Finance Director (3, 5 & 7)*

Ron Henderson, 59, was formerly Group Finance Director of BICC plc, Finance Director of Balfour Beatty, and most recently Chief Executive of Tuberail.

Charles Hoppe

Non-Executive Director (2 & 6)*

Charles Hoppe, 70, is the former Vice President, Operations and Facilities Planning, United States Railway Association, Senior Vice President of Booz, Allen & Hamilton's worldwide rail consulting practice and President of the Long Island Rail Road.

Ian McAllister CBE

Chairman (2 & 4)*

Ian McAllister, 61, is the Company's Non-Executive Chairman having previously been Chairman and Managing Director of Ford Motor Company Limited. Ian is also Chairman of the Carbon Trust and Senior Independent Non-Executive Director of Scottish & Newcastle plc.

Ross Sayers

Non-Executive Director (1, 2, 5 & 6)*

Ross Sayers, 63, is a former Chairman and Chief Executive of New Zealand Railways Corporation, Chairman and Chief Executive of the State Rail Authority of New South Wales, Australia, and was Chairman of Associated British Ports Holdings PLC until April 2004. He is currently Chairman of Macquarie European Infrastructure Fund Advisory Panel. He was appointed the Senior Independent Director of Network Rail in December 2004.

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

1 Audit Committee
2 Remuneration Committee
3 Executive Committee
4 Nominations Committee
5 Property Advisory Board
6 Safety, Health and Environment Committee
7 Treasury Committee

Directors' remuneration report

The following report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002 (the Regulations) and the Revised Combined Code issued in July 2003.

The Remuneration Committee

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

Jim Cornell – Chairman of the Committee
David Bailey
Robert den Besten
Yvonne Constance*
Michael Firth**
Charles Hoppe
Ian McAllister
Ross Sayers

* Joined the Committee in May 2005.
** Joined the Committee in December 2004.

Adrian Montague was a member of the Committee until December 2004 when he resigned as a Non-Executive Director of the Company.

The Committee is required under its terms of reference to meet at least three times a year and during the year 2004/05 it met seven times, primarily due to the need to consider in depth the terms of the incentive arrangements for 2005/06. The Group Company Secretary is the secretary to the Committee.

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

Additionally the Committee determines the framework of certain senior executive employees' remuneration as well as the form and content of their MIP.

During the year the Committee's activities included:

- finalising the MIP 2004/05;
- preparing the MIP 2005/06;
- reviewing the benchmarking of basic salaries.

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

The Committee commissioned New Bridge Street Consultants LLP to provide independent expert advice on the management incentive schemes and remuneration generally. Mercers Human Resources Consulting Limited advises the Company in respect of pension related matters included in the remuneration policies. These advisers do not provide other services to Network Rail.

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

Directors' remuneration policy

The Company has a network licence condition requirement to have a Management Incentive Plan (MIP) for Executive Directors and senior executives and for that plan to be cascaded throughout Network Rail.

Under this condition Network Rail is required, when formulating its MIP, to have particular regard to:

- securing the operation and maintenance, renewal and replacement, improvement, enhancement and development of the network especially operational performance, asset serviceability and condition, efficiency, economy and safety;
- achievement of the licence requirement of dealing with dependent persons with due efficiency and economy and in a timely manner and compliance with Network Rail's code of practice for dealings with dependent persons;
- the extent to which Network Rail is subject to orders and to statements by the Office of Rail Regulation on non-compliance with the licence;
- infringement by Network Rail of any access contracts and safety factors.

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

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

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

- provide strong incentives to deliver the actions and objectives specified in the Business Plan;
- identify specific accountability for the achievement of the actions and objectives laid out in the Business Plan;
- enable Network Rail to recruit, retain and motivate individuals with the right skills, knowledge, experience and competencies;

- draw on best practice for listed companies in the UK, where appropriate, given the unique mission and structure of Network Rail;
- recognise that Network Rail is accountable for the public interest as a monopoly owner and operator of an asset of considerable public importance;
- recognise that Network Rail is a company limited by guarantee founded on a not-for-dividend principle;
- reflect the fact that the Company is unable to offer the traditional benefits of UK listed companies including stock options and other profit share mechanisms.

These are structured within a total remuneration approach, defined as the sum of base salary, incentives and benefits. The use of variable pay through the availability of incentives to form a significant part of total remuneration is intended to ensure that each individual's reward is clearly linked to the successful delivery of Company objectives.

Account is taken of information from internal and independent sources on the remuneration for comparable positions in relevant FTSE 350 companies. The strategy for Executive Directors' pay is for base salaries broadly to reflect the relevant market median, for benefits such as car allowance and medical insurance to reflect market practice, for pensions to reflect the rail industry practice and for total direct compensation (i.e. base salary and incentives) to be broadly competitive in the appropriate marketplace, provided always that performance justifies the amount. This strategy is consistent with the Company's belief that performance should determine a sizeable proportion of the total remuneration package for Executive Directors.

Through the following means the Company ensured that there was suitable transparency as to the principles upon which remuneration of the Directors of the Company has been set during the year:

- publication of a statement in October 2004 detailing the contents of the Executive Directors' MIP 2004/05 (pursuant to the terms of the Company's network licence);
- presentation at the Annual General Meeting of Network Rail Limited held in July 2004 by the Chairman of the Remuneration Committee of the principles adopted by the Committee in setting the remuneration policy and the MIP 2004/05;
- a resolution being put to the Members of Network Rail Limited at the Annual General Meeting held in July 2004 for approval of the long-term incentive element of the MIP 2004/05 which was approved;
- briefing meetings with Members of Network Rail Limited during March 2005 where Members had the opportunity to discuss remuneration and potential awards under the MIP 2004/05.

Additionally in May 2005 the Company has published a statement detailing the contents of the Executive Directors' MIP 2005/06 (pursuant to the terms of the Company's network licence).

Executive Directors' reward package

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

Base salary

This is a fixed cash sum payable over 13 periods during the financial year. The Committee reviews salaries annually as part of the total reward package recognising market levels and personal contribution. The aim is to ensure that salaries are competitively set at broadly median levels in relation to similar roles in appropriate companies within the FTSE 350.

Current salaries for the Executive Directors, following the most recent salary review effective from 1 July 2004 are:

Executive Director	Annual base salary as at 31 March 2005 £
John Armitt	485,000
Iain Coucher	433,000
Peter Henderson	323,000
Ron Henderson	323,000
Chris Leah*	323,000

* This represented annual base salary at the date of his retirement in December 2004.

Incentive arrangements

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

Details of the MIP 2005/06 were published in May 2005. This applies to all the Executive Directors of the Company and senior executives.

MIP 2004/05 – annual incentive

As detailed in last year's Annual Report the annual bonus for 2004/05 was to be calculated measuring actual Company performance against the three equally weighted targets set in the MIP 2004/05. These were Train Delay Minutes, Asset Stewardship Incentive Index (ASII) and Financial Efficiency Index (FEI). For each measure a target level and maximum level of achievement was set, with maximum level representing at least the achievement of the 2005/06 Business Plan a year early. Achievement between target level and maximum was calculated on a "straight line" basis. For the year 2004/05, all three measures achieved at least target level, as outlined below. The following level of bonuses thus became payable under the terms of the MIP 2004/05:

- in respect of Train Delay Minutes, the target figure was 12.3m minutes with a maximum target of 11.3m minutes. The actual result was 11.434m minutes, producing a payment of 93.30% of the maximum of 20% of salary payable for this element;
- in respect of ASII the target was 1.07 with a maximum target of 1.05. The actual result was 0.90 and payment was therefore made at the maximum level of 20% of salary due on this element;
- in respect of FEI the target level of achievement was 2,199 and maximum of 2,120. The actual result of 2,144 produced a payment of 84.81% of the maximum of 20% of salary payable for this element.

The resultant total potential award was 55.62% of basic salary. In accordance with the terms of the MIP the Committee then considered whether to use its discretion by reducing the overall bonus award for the Executive Directors having regard to the requirements of Network

Directors' remuneration report

Rail's network licence especially in relation to non-compliance with the network licence. After due consideration the Committee concluded that, notwithstanding the issues relating to the Informed Traveller programme, in the light of the substantial performance improvements made by the Company during the year 2004/05, including the successful in-sourcing of infrastructure maintenance, it was not appropriate to exercise its overriding discretion to reduce the bonus award.

Details of the bonus payments awarded to each Director are detailed on page 21 below.

MIP 2005/06 – annual incentive

Participants under the MIP 2005/06 are eligible to receive bonuses based on demanding business performance measures and targets. The MIP 2005/06 uses key performance indicators (KPIs) based upon those contained in the 2005 Business Plan but in certain respects more stretching as objectives.

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

Business performance measures

The amount payable to Executive Directors is calculated by reference to performance against the same three output measures used in the 2004/05 MIP:

Network delay minutes (weight one-third) – this is the number of minutes of train delays attributable to Network Rail (rather than the train operating companies (TOCs)) as defined in the contractual performance regime with operators. This measurement of network operating efficiency is felt to be the appropriate measure for inclusion in the annual incentive, with PPM used as one of the two key measures in the long-term incentive.

Financial efficiency (weight one-third) – this is a measure of the efficiency of operations, maintenance, track renewals and other key central expenditure.

Asset Stewardship Incentive Index (weight one-third) – this is an index proposed by the ORR in its December 2003 access charges review. The components of this index and weightings are: track geometry index (20%), number of broken rails (15%), Level 2 exceedences (15%), total number of signalling failures (15%), wrongside signalling failures – hazard rating 20 or above (15%), structure and earthworks train speed restrictions (10%), and traction power supply failures AC and DC (10%).

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

Payments under each of the three measures can only be made if performance meets or exceeds the targets included in the 2005 Business Plan. If target levels are achieved payments are calculated for above-target performance on a "straight line" basis up to "maximum" target level; the maximum incentive could be earned by achieving a level of performance at least equal to delivering one year early the 2006/07 performance on each measure as contained in the 2005 Business Plan.

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

Personal performance measures

There are no individual performance measures set for the Executive Directors as the Committee continues to believe that collective accountability of the Directors and the need to establish the stability of the organisation continues to necessitate a focus on collective performance incentives without individual performance measures for the Executive Directors. Other senior executives do have individual performance measures in addition to the business performance measures.

The potential annual incentive entitlement if all three measures achieve target level is 30%. The maximum possible entitlement is 60% of salary, achievable only if all three measures hit maximum performance, by achieving a level of performance equal to or better than the 2006/07 performance as described in the 2005 Business Plan.

The remuneration potential has been benchmarked against external comparators with the aim to achieve competitive levels set at broadly median levels for comparable organisations.

Long-term incentive

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

As Network Rail Limited, being the ultimate parent company of Network Rail Infrastructure Limited, is a company limited by guarantee it is not possible to use traditional long-term incentives due to the absence of shares as the reward method.

At the 2004 Annual General Meeting of Network Rail Limited its Members approved the proposal by the Committee for a long-term incentive based on a deferred cash payment in which awards are made after each three-year period triggered by relevant long-term improvement in business performance targets that reflect the Business Plan and the funding determined by the ORR's Interim Review. The maximum amounts which could be earned under each three-year long-term incentive cycle are a cash sum equivalent to that earned under the previous year's annual incentive.

The annual incentive awards made in the 2003/04 financial year were used to set the maximum long-term incentive for that three-year scheme, running from 2003/04 to 2005/06, as well as for the scheme to run from 2004/05 to 2006/07. As such the long-term incentive applies both to the three-year period commencing in 2003/04 and to that commencing in 2004/05. The 2004/05 annual incentive awards will set the maximum long-term incentive for the three-year scheme running from 2005/06 to 2007/08.

Therefore the maximum potential value of the long-term incentives receivable by each Executive Director at the end of the respective performance periods is as follows:

Director	Performance period 1 April 2003 to 31 March 2006 £	1 April 2004 to 31 March 2007 £	1 April 2005 to 31 March 2008 £
John Armitt	112,320	112,320	269,757
Iain Coucher	99,840	99,840	240,834
Peter Henderson	74,880	74,880	179,652
Ron Henderson	74,880	74,880	179,652
Total	361,920	361,920	869,895

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

Performance measures

The two performance measures are:

Public performance: This measure, which in 2003/04 was included in the annual incentive, is felt to be the most appropriate measure of network performance for inclusion in this long-term incentive, reflecting delays attributable both to Network Rail and the TOCs. This measure is the percentage of trains arriving on time over each twelve-month period as published in "National Rail Trends". "On time" is defined as running as planned and arriving less than five minutes late at final destination or less than ten minutes late for inter-city operators. The target level of achievement for full payment to be made under this measure is a Public Performance Measure (PPM) at the level included in the relevant Business Plan.

Cost reduction: This measure reflects the cumulative cost reductions made in the relevant three-year period. For full payment under the long-term incentive the target is achievement of the level laid down by the ORR. No award under the long-term incentive will be payable unless at least 80% of the cumulative savings set by the ORR are achieved.

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

For the period from 1 April 2005 to 31 March 2008, the PPM target is 88.7% (reflecting the target at 31 March 2008 as described in our 2005 Business Plan). No award under this measure will be made if PPM is below 87.7%. The target for cumulative cost reductions is the one for the three-year period to 31 March 2008 as set by the ORR. No award under this measure is payable unless at least 80% of the cumulative savings set by the ORR are achieved.

Regulatory MIP statement

As required under the Company's network licence, a statement was published by the Committee in May 2005 detailing the contents of the Executive Directors' MIP 2005/06.

Pensions

Executive Directors are entitled to pensions based on salary and length of service with the Company with a maximum pension of two-thirds of final base salary. Details are set out on page 22.

Directors' service terms

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

At the time of drawing up the service agreements the Committee took into consideration the UK Listing Authority's corporate governance code and the recommendations contained within the joint statement of the Association of British Insurers and the National Association of Pension Funds published in December 2002 on best practice on executive contracts and severance. These were applied as far as practicable and appropriate having regard to the nature of the business and the corporate structure of the Company and current practice.

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

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

Executive Directors	Effective date of contract
John Armitt	14 December 2001
Iain Coucher	3 October 2002
Peter Henderson	3 October 2002
Ron Henderson	3 October 2002
Chris Leah*	5 October 1998

* Chris Leah retired on 3 December 2004.

Non-Executive Directors are appointed by the Board on recommendation of the Nominations Committee. Their appointment is for an initial term of three years, subject to election by the Members of Network Rail Limited at the first AGM following their appointment. They do not have service agreements. Instead the terms of their engagement are set out in a letter of appointment and, in accordance with the Company's

Directors' remuneration report

articles of association, their appointments may be terminated at any time on six months' notice without compensation.

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

Non-Executive Directors	Effective date of contract
Ian McAllister	3 October 2002
David Bailey	3 October 2002
Rob den Besten	24 September 2003
Yvonne Constance	1 May 2005
Jim Cornell	3 October 2002
Michael Firth	4 December 2004
Charles Hoppe	3 October 2002
Adrian Montague*	3 October 2002
Ross Sayers	3 October 2002

* Adrian Montague resigned from the Board with effect on 4 December 2004.

External appointments

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

With the approval of the Committee, Ron Henderson is a Non-Executive Director of Scipher plc. During 2004 he resigned as a Non-Executive Director of NHP plc. Both positions were held by him prior to joining Network Rail and as such the Committee considered it appropriate that he continued to hold these and that the fees from them were retained by him.

None of the Executive Directors currently hold Non-Executive Director positions with listed companies.

Non-Executive Directors' remuneration

The Non-Executive Directors of the Company are also the Non-Executive Directors of Network Rail Limited. Each Non-Executive Director has a letter of appointment with either the Company or Network Rail Limited but not with both companies nor do other contractual provisions or remuneration arrangements exist in relation to their directorships (if any) of any other company within the Network Rail Group. For the purpose of this Directors' Remuneration Report and the Directors' Remuneration Report for Network Rail Limited, therefore, the following provisions of this Report relate to letters of appointment of the Non-Executive Directors of Network Rail Infrastructure Limited or Network Rail Limited as appropriate and they also appear in the Annual Report of Network Rail Limited. The letters of appointment are available for inspection at the Company's registered office.

Non-Executive Directors receive only a fee together with their reasonable expenses for attending meetings of the Board and other meetings and events.

With effect from January 2005 it was decided that, in view of the additional responsibilities and time commitment placed upon the chairmen of Board committees, and in line with the recommendations of the Higgs Report and good corporate governance practice, additional fees would be paid to a Non-Executive Director who chairs any of the following Board committees (details are set out in the table below):

Audit Committee
Remuneration Committee
Safety, Health & Environment Committee

Non-Executive Directors do not receive any other benefits from the Company.

With the exception of the fee for the Chairman (which is determined by the Remuneration Committee), the fees of the Non-Executive Directors are agreed by the Executive Directors of the Board and are designed to recognise the significant responsibilities of Non-Executive Directors and to attract individuals with the necessary high-quality experience and ability to make an important contribution to the Company's business. The fees, which are neither performance related nor pensionable, are benchmarked and periodically reviewed against, and are in line with, those paid by other comparable private sector companies taking into account time commitment and competition for similar positions in other companies.

Current annual fees for the Non-Executive Directors are:

	Fee £
Non-Executive Director	
David Bailey	37,000
Robert den Besten	37,000
Yvonne Constance	37,000
Jim Cornell[1]	50,000
Michael Firth	37,000
Charles Hoppe	37,000
Ian McAllister	210,000
Ross Sayers[1]	50,000

1 Includes additional fees paid with effect from 1 January 2005 for their chairmanship of Board committees.

Directors' emoluments (audited)

Disclosure of Directors' remuneration for 2004/05

Name	Notes	Salaries and fees £000	Bonuses £000	FURBS and AVC payments by the Company £000	Benefits £000	2004/05 Total £000
J Armitt		480	270	144	25	**919**
D Bailey		35				**35**
R den Besten		35				**35**
J Cornell	1	37				**37**
I Coucher		428	241	124	36	**829**
M Firth	2	11				**11**
P Henderson		320	180	91	16	**607**
R Henderson		320	180	91	20	**611**
C Hoppe		35				**35**
C Leah	3	227		73	12	**312**
I McAllister		210				**210**
A Montague	4	48				**48**
R Sayers	1	38				**38**

1 Includes additional fees paid with effect from 1 January 2005 for their chairmanship of Board committees.
2 Covers period from 4 December 2004 (being the date of appointment as Director) to 31 March 2005.
3 Covers period from 1 April 2004 to 3 December 2004 (being the date of retirement).
4 Covers period from 1 April 2004 to 4 December 2004 (being the date of resignation as Director).

Directors' remuneration comparison: 2004/05 against 2003/04

	Notes	2004/05 Total £000	2003/04 Total £000
Current Directors			
J Armitt		**919**	729
D Bailey		**35**	35
R den Besten	1	**35**	18
J Cornell		**37**	36
I Coucher		**829**	665
M Firth	2	**11**	0
P Henderson		**607**	486
R Henderson		**611**	483
C Hoppe		**35**	35
I McAllister		**210**	210
R Sayers		**38**	35
Ex-Directors			
C Leah	3	**312**	508
A Montague	4	**48**	70
Total		**3,727**	3,310

1 Joined Board on 24 September 2003.
2 Joined Board on 4 December 2004.
3 Left Board on 3 December 2004.
4 Left Board on 4 December 2004.

The total amount of Directors' emoluments for services provided solely to the Company during the year was £3,727,000 (2003/04: £3,330,000).

Directors' pensions (audited)

The table on page 22 shows the pension entitlement from the Network Rail section of the Railways Pension Scheme (RPS), and unapproved arrangements of each Executive Director of the Company during the year ended 31 March 2005, together with the increases in those benefits during the year, calculated using the accrued benefit basis.

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

The increase in accrued approved benefit during the year is shown in the table on page 22. Values are shown before (column A) and after (column B) the exclusion of the effect of inflation. All benefit values shown exclude the effect of any additional voluntary contributions made by the director.

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

The following sections describe the pension benefits received by Executive Directors in 2004/05:

Directors' remuneration report

Core pension benefits

	Gross increase in accrued RPS pension £ (A)	Increase in accrued RPS pension net of inflation £ (B)	Total accrued RPS pension at 31 Mar 2005 £ (C)	Transfer value of accrued RPS pension at 31 Mar 2004 £ (D)	Transfer value of accrued RPS pension at 31 Mar 2005 £ (E)	Total change in transfer value during period £ (F)	Value of net increase in accrual over period £ (G)
J Armitt	1,814	1,712	5,589	72,380	109,254	29,149	25,743
I Coucher	1,774	1,708	4,220	22,955	42,526	11,846	9,486
P Henderson	1,774	1,708	4,220	32,267	60,049	20,056	16,578
R Henderson	1,783	1,709	4,513	52,382	88,146	28,038	25,648
C Leah*	10,933	5,581	208,513	3,765,539	4,118,101	336,377	90,780

* Covers period from 1 April 2004 to 3 December 2004 (being the date of retirement).

1 Pension accruals shown are the amounts which would be paid annually on retirement (or earlier leaving) based on service to the end of the year.
2 Transfer values as at 31 March 2004 (D) and 31 March 2005 (E) have been calculated in accordance with version 8.1 of guidance note GN11 issued by the actuarial profession.
3 The change in the transfer value (F) includes the effects of fluctuations in the transfer value due to factors beyond the control of the Company and Directors, such as stock market movements. It is calculated after deducting the Director's contribution.
4 The value of net increase (G) represents the incremental value to the Director of their service during the year, calculated on the assumption that service terminated at the year end. It is based on the accrued pension increase (B) after deducting the Director's contribution.

In normal circumstances the earliest age at which the Executive Directors are entitled to receive their defined benefit pension without actuarial reduction is age 60. However, the Directors can retire early on the same terms and conditions that apply to other members of the Network Rail section of the RPS from the age of 50. The actuarial reduction factors that apply under the RPS are a 2% per annum reduction between the ages of 60 and 55 and a 3% per annum reduction for ages below 55. In keeping with other members of the scheme, the right to take early retirement benefits is at the option of the individual, subject only to having left the Company's employment.

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

Additional pension benefits

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

The RPS also operates a matching additional voluntary contribution facility, whereby voluntary contributions paid by members are matched by equivalent payments from the Company, up to certain limits. These matching arrangements were "frozen" for all members of the Network Rail section of the RPS at the levels applicable on 6 November 2003, and this limit was applied to Directors as to other members. Matching payments made in 2004/05 are also shown opposite.

	Company contributions to additional pension provision whilst a Director during the year £ (H)	Company payments to additional pension provision in respect of prior year £ (I)	Matching Company additional voluntary contributions whilst a Director during the year £ (J)
Current Directors			
J Armitt	139,128	–	4,844
I Coucher	124,406	–	–
P Henderson	91,627	–	–
R Henderson	90,975	–	–
Ex-Director			
C Leah	67,401	–	5,904

1 The current Directors were Directors for the whole year. The directorship of C Leah ceased with effect on 3 December 2004.
2 The contributions in respect of previous years are not included in column (H).
3 None of the Non-Executive Directors are members of the Network Rail section of the RPS and they have no other pension entitlements.

The Company is currently reviewing the manner in which additional pension arrangements are provided as a result of changes in pensions legislation that take effect from April 2006. Whilst final decisions have not yet been taken, the Committee is of the view that in principle that there will be no overall increase in Company costs as a result of any such changes.

Performance graph

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

Directors' interests

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

On behalf of the Remuneration Committee

Jim Cornell
Chairman, Remuneration Committee
26 May 2005

Corporate governance report

Corporate governance principles

The Board considers that good corporate governance is central to achieving the Company's objectives and to the principle of safeguarding stakeholders' interests in the rail infrastructure. The Company is committed to high standards of business behaviour and has an established governance framework which comprises an organisational structure, internal control systems and business conduct policies.

It is also a condition of the Company's network licence that, from 3 October 2002, it complies with the governance principles contained in the code annexed to the UK Listing Authority's listing rules ("the Code"). The Code includes a requirement for companies to make statements on corporate governance in their annual reports. A new Code was issued by the Financial Reporting Council in July 2003 and came into effect for reporting years commencing on or after 1 November 2003. Each provision of the new Code was reviewed and, where necessary, steps were taken to establish compliance by the Company with these provisions.

The Directors consider that Network Rail has complied throughout the year ended 31 March 2005 with the provisions set out in Section 1 of the Code. This Corporate Governance Report, coupled with the Directors' Remuneration Report, explains how the Company has applied the governance principles set out in the Code. Details of the Company's internal controls are set out on pages 28 to 29.

Board of Directors

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

Directors

The information on page 15 shows that the Company is led and controlled by a Board currently comprising four Executive and eight (soon to be nine) Non-Executive Directors with wide experience both within the rail industry and generally. Collectively, the Board believes it possesses the necessary range of qualities, skills and experience to lead the Company effectively.

Directors are appointed by the Board. The Directors of the Company are also the Directors of Network Rail Limited. Under the articles of association of the Company the Directors are not subject to retirement by rotation (as required under the Code), due to it being a wholly-owned subsidiary of Network Rail Limited. Under the provisions of the Articles of Association of Network Rail Limited, however, all directors (other than the Special Director – see below), must retire by rotation, and may stand (together with any new Director appointed since the last general meeting) for re-election by the Members of that Company at least once every three years.

The names of the Directors standing for election and re-election at the 2005 AGM are set out on page 11 of the Directors' Report and further information will be given in the documents accompanying the Notice of the AGM to be sent to Members.

The Strategic Rail Authority (SRA) has rights under the Articles of Association of Network Rail Limited to appoint a special director to the Board of the Company (Special Director) who is not subject to election or re-election by Members.

The responsibilities of the Chairman include leading the Board and ensuring its effectiveness. He sets the agenda for the meetings of the Board and, with the assistance of the Group Company Secretary, ensures that the Directors receive timely, accurate and clear information before Board meetings and updates on issues arising between meetings.

The roles of the Chairman and the Chief Executive are distinct and separate and their responsibilities are clearly established, set out in writing and have been agreed by the Board. The Chairman is responsible for the workings and leadership of the Board. The Chief Executive is responsible for leading and managing the business within the authorities delegated by the Board.

The Non-Executive Directors constructively challenge and contribute to the development of the strategy of the Company as well as scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance.

The current Senior Independent Director is Ross Sayers who took up this role in December 2004 upon the resignation from the Board of Adrian Montague, the previous Senior Independent Director. He is available to Members as an additional point of contact to the Chairman and the Chief Executive.

Non-Executive Director independence

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

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

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

2 David Bailey is currently the Special Director appointed to the Board of Network Rail Limited by the SRA pursuant to its rights under the Articles of Association of that Company.

None of the Non-Executive Directors is a member of more than three committees of the Board except:

1 David Bailey, who is a member of the Nominations and Remuneration Committees of the Board due to his nomination to the Board in accordance with the Articles of Association of Network Rail Limited as the Special Director. Further by request of the SRA he is also a member of the Audit and Safety, Health and Environment Committees. Upon the conversion of his appointment in June 2005 to non-executive director, he will continue to be a member of these committees due to the valuable contribution he is able to make.

2 Ross Sayers is Chairman of the Audit Committee given his significant financial experience (including being a Fellow of the Institute of Chartered Accountants of New Zealand) and Chairman of the Property Advisory Board due to his general commercial experience. He is also a member of the Safety, Health and Environment Committee due to his railway experience and a member of the Remuneration Committee due to the decision of the Board of Network Rail that all Non-Executive Directors would be members of this important committee.

Board meetings

The Board is scheduled to meet ten times a year and a format is prepared and agreed which ensures that the Directors are able to review corporate strategy regularly together with the operations and results of the business units within the Company and to discharge their other duties. A table detailing the individual Directors' attendance at each of the Board and committee meetings is set out on page 27.

In addition to these meetings, the Board met in the year on one occasion to focus on the future strategy of the business.

Certain matters are formally reserved for decision by the Board including approval of the interim and year-end financial statements of the Company, the Business Plan, material changes to the network licence and pension matters. Matters delegated to executive committee or below are also subject to financial limits above which Board approval is required.

In addition, the Chairman held one meeting with the Non-Executive Directors without the Executive Directors present. Further, one meeting of the Non-Executive Directors chaired by the Senior Independent Director was held without the Chairman present.

Organisational structure

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

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

The Safety, Health and Environment Committee comprises four Non-Executive Directors and the Chief Executive. The Committee's role is to monitor the safety, health and environmental responsibilities of the Company. In addition to this Committee, reflecting the recommendations in the Cullen Report, two executive committees have been set up, dealing with strategic and tactical safety matters. Moreover, the Board receives a report on safety, health and environment matters at each of its scheduled meetings.

The Audit Committee comprises exclusively four independent Non-Executive Directors with the Chairman, being a Fellow of the Institute of Chartered Accountants of New Zealand. The external auditors, the Chief Executive, the Group Finance Director, the Group Financial Controller and the Head of Internal Audit normally attend meetings of the Committee. The Committee also periodically meets with the external auditors without management present.

The Board is satisfied that the composition of the Committee fulfils the Code's requirement that at least one member of the Committee has recent and relevant financial experience. The Company has also complied with the Smith Guidance on Audit Committees in all material respects.

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

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

Corporate governance report

2 monitoring financial reporting practices including considering accounting policies and practices and compliance with accounting standards;

3 reviewing significant accounting estimates and judgements;

4 reviewing interim and annual financial statements before publication;

5 considering and making recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditors following its assessment of their independence and objectivity (including the safeguards that are in place to maintain such independence) and their terms of engagement and remuneration;

6 setting a policy whereby employment of the external auditors for work for Network Rail other than audit services or tax consulting services is prohibited, as is submission of tenders to the Network Rail Group in response to EU notices for other services, without approval by the Audit Committee;

7 reviewing the internal and external audit process including the scope of its planned audit and subsequently its audit findings; and

8 reviewing the policy and procedure whereby employees can raise, in confidence, concerns about possible improprieties.

During the year ended 31 March 2005, the principal activities of the Audit Committee included consideration of the following:

- interim and full-year financial results;
- the 2005/06 internal audit plan;
- quarterly internal control reports from the internal audit function;
- the effectiveness of the internal audit function;
- the effectiveness of the external audit process;
- the independence and objectivity of the external auditors;
- the 2005 external audit plan and associated audit fees;
- the Company's internal control framework including the risk management process and progress on the management of the key risks identified by the Company;
- the introduction of International Financial Reporting Standards;
- the Annual Report disclosure items relevant to the Audit Committee.

Following its recent review of the external auditors the Audit Committee has recommended to the Board that it proposes at the AGM in July 2005 the re-appointment of Deloitte & Touche LLP as auditors until the conclusion of the AGM in 2006.

The Remuneration Committee comprises all nine Non-Executive Directors, chaired by one of them, and determines appropriate levels of Directors' and senior executives' remuneration including their incentive scheme. The Committee's Report is contained in pages 16 to 23.

The Nominations Committee is chaired by the Chairman of the Board and comprises two further Non-Executive Directors. The role of the Committee includes:

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

During the financial year 2004/05 the Nominations Committee has met to consider performance evaluation of the Board, its committees and Directors, succession planning and candidates for appointment as Non-Executive Directors of the Company.

In relation to considering the status of succession plans for the Executive and Non-Executive Directors as well as senior executives within business functions, work was undertaken to identify candidates for appointment of further Non-Executive Directors to the Board. This included replacement for Adrian Montague who retired from the Board in December 2004. This process included preparation of descriptions of experience and skills sought for the roles and commissioning Egon Zehnder International to conduct various searches for suitable candidates and interviewing candidates. Through this process Mike Firth, Yvonne Constance and Christopher Green were selected and nominated by the Committee for approval by the Board. The nomination was approved and Mike Firth and Yvonne Constance joined the Board with effect on 4 December 2004 and 1 May 2005 respectively. Christopher Green will join on 26 June 2005. Details of the number of times the Committee met during the year are set out on page 27 of this Report.

The Treasury Committee comprises three Directors, including one Non-Executive Director who chairs the Committee. This 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.

During the year ended 31 March 2005, the principal activities of the Treasury Committee included consideration of the following in relation to the various funding arrangements in for the Company:

- review of the Debt Issuance Programme (including structural notes);
- review and extension of the Commercial Paper Programme;
- renewal of the Clearing Bank contract;
- renegotiation of intercompany loan facilities;
- review and renegotiation of legacy debt arrangements (including finance leases, KfW and EIB loans);

- review of the Control Period Hedging Strategy;
- review of the implications of International Financial Reporting Standards on hedging accounting designation policy;
- review of counterparty limits;
- guarantees of the obligations of the Company.

The Executive Committee is chaired by the Chief Executive and comprises all the Executive Directors and a number of senior executives. This Committee manages the functions of the business and implements the operational and financial objectives within limits set by the Board.

The Property Advisory Board (previously called the Property Board) comprises a Non-Executive Director as Chairman, the Executive Directors, the Company's Railway Estates Director and, selected for their expertise in relevant property matters, three external non-executives and a special adviser. The Committee's role is to review and provide advice on the Company's strategic development of its property portfolio.

The following table identifies the number of Board and main committee meetings held between 1 April 2004 and 31 March 2005 and the attendance record of individual Directors:

	Board	Safety, Health and Environment Committee	Nominations Committee	Remuneration Committee	Audit Committee	Executive Committee	Treasury Committee	Property Advisory Board
Number of meetings held	10	7	4	7	4	11	3	6
Directors								
J Armitt	10	6	–	7*	4*	10	3	6
D Bailey	10	7	4	6	2	–	–	–
R den Besten	10	–	–	7	4	–	–	–
J Cornell	10	7	4	7	–	–	–	–
I Coucher	10	1*	–	–	–	11	–	4
M Firth[1]	3	–	–	2	1	–	1	–
P Henderson	10	–	–	–	–	11	–	2
R Henderson	10	–	–	–	4*	9	3	6
C Hoppe	10	7	–	7	–	–	–	–
C Leah[2]	7	2*	–	–	–	5	–	–
I McAllister	10	–	4	7	–	–	–	–
A Montague[3]	6	–	–	3	1	–	2	4
R Sayers[4]	10	7	–	6	4	–	–	3

* As attendee.

1 Between 4 December 2004 (being the date on which Michael Firth joined the Board of Directors) and 31 March 2005.
2 Between 1 April 2004 and 3 December 2004 (being the date on which Chris Leah resigned from the Board of Directors).
3 Between 1 April 2004 and 4 December 2004 (being the date on which Adrian Montague resigned from the Board of Directors).
4 Between 11 February 2005 and 31 March 2005 (being the date Ross Sayers became Chairman of the Property Advisory Board).

Company Secretary

The Group Company Secretary is the secretary to the Board, the above committees and the Property Advisory Board. All directors have access to the Group Company Secretary for advice on corporate governance, Board procedure and compliance matters. The Group Company Secretary is also responsible for facilitating the induction and professional development of Board members and ensuring that good information flows within the Board, its Committees and between the Non-Executive Directors and senior management.

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.

Information about the Directors' remuneration is given in the Directors' Remuneration Report on pages 16 to 23 of this Report and details of how the Board reviews financial and operational controls and risk management generally are shown on pages 28 to 29 and in the financial review on pages 7 to 9.

Board effectiveness

There is a comprehensive programme of induction for new Directors aimed at ensuring that they are fully conversant with their responsibilities as a Director and with the business of Network Rail.

Ongoing professional development is provided to Directors. During the year the Directors were briefed on relevant issues including legislative, corporate governance and financial reporting matters such as the introduction of International Financial Reporting Standards. Additional personal development is also available to all Directors.

Corporate governance report

Board evaluation

The Nominations Committee is charged by the Board to review the performance of the Board. Each of its committees and Directors has been reviewed during the year to assess whether each of these has been contributing effectively and demonstrating commitment to their role. For the year 2003/04 the Nominations Committee commissioned consultants, Egon Zehnder International, to assist this review. For the year 2004/05 the Nominations Committee decided that external reviews such as that conducted in 2004 would be repeated every two to three years. In the interim, annual internally managed reviews would take place. Such an internal review took place in March 2005 based upon the same detailed questionnaire as that used by the external advisers. The questionnaire focused on matters such as company strategy, performance, delegation and accountability, corporate responsibility, succession, relationships with stakeholders, Board and committee composition and Board communication.

The Chairman of the Board and the other members of the Nominations Committee have considered the findings of the review. The results were also presented to the other Board members.

In addition the performance of individual Non-Executive Directors has been evaluated by the Chairman with input from the Group Company Secretary. Also the performance of individual Executive Directors has been reviewed by the Non-Executive Directors, led by the Chairman. The evaluation of the Chairman was conducted by the Non-Executive Directors led by the Senior Independent Director.

The Directors have concluded that the Board and its committees operate effectively and consider that each Director is contributing to the overall effectiveness and success of the Company.

Relations with Members and stakeholders

The Board is committed to, and recognises the importance of, maintaining an ongoing relationship based on regular communication with its stakeholders.

The Annual General Meeting (AGM) for Members of the Company's ultimate parent company Network Rail Limited was held in July 2004, at which the Members were advised of developments within the Company. Presentations were also provided on certain aspects of the business to assist Members in their understanding. Members are given the opportunity to ask questions at the AGM and to submit written questions in advance. Members are also encouraged to request areas of the business on which they would like presentations.

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

The next AGM of Network Rail Limited will be held on 20 July 2005.

In addition, other meetings, informal briefings and visits for the Members of Network Rail Limited were held, to give them opportunities to discuss all aspects of the business. They also receive periodic newsletters and press releases and other information relating to the Company.

Further the Company's website is updated frequently with announcements, the annual Business Plan, the Annual Report and Accounts, the Management Incentive Plan statement and other documents and information.

During the year discussions have taken place between the Company and its Members as to whether and if so in what format there should be a method by which Members can meet amongst themselves to discuss issues relating to the Company. These discussions are on-going.

The Chief Executive, the Deputy Chief Executive and the other Executive Directors have regular meetings with representatives of the SRA, the ORR, train operators, freight operators and other rail stakeholders. Certain of the Non-Executive Directors have also met with the SRA and the ORR.

Internal control

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

The Board has formally established a policy, strategy and process for identification, evaluation and on-going review of the significant risks faced by the Group which accords with the Turnbull guidance. During the year the Executive Directors have formally reviewed the key risks faced by the Group in the light of the implementation of the Company restructuring programme, which included bringing maintenance activities in house.

Good progress has been made in developing the Company-wide integrated risk management system including:

- development and integration of a systematic bottom up process to identify key risks and mitigation and to link with the already established top-down strategic risk management process;
- interface of risk management actions and mitigation with the Business Planning process;
- establishment of risk reporting and monitoring in the Company's existing review mechanisms;
- extensive involvement of managers from all functions in risk identification workshops enhancing risk awareness across the Company.

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

- regular structured reviews of business units by the Executive Directors;
- a framework of delegated authority and accountability based on a fully-templated organisation structure;
- the pre-approval of business plan budgets and major investment;
- the monthly reporting of financial results, safety and other operational key performance indicators;
- the control framework for managing all investment (GRIP – Guide to Railway Investment Projects).

The Directors keep the system of internal control under review and have done so throughout the year. The Audit Committee approves the internal audit plan, reviews the external audit programme and receives regular reports from both the internal and external auditors who have direct access to the Chairman of the Audit Committee. Recommendations to improve the internal control framework are reported to the Audit Committee through this process.

The Company also has an established process by which employees may, in confidence, raise concerns about possible improprieties.

Notwithstanding the above, the Board recognises that there is still an on-going need to build on the above framework and, in particular, has instigated a number of initiatives to further improve compliance with the control framework.

Moreover, during the year the Government published the outcome of its Rail Review. The Board recognises that there are likely to be transitional risks associated with implementing the organisational changes required to effect the terms of the Review. An appropriate change programme and governance structure has been put in place to manage these.

Going concern

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

Statement of Directors' responsibilities

United Kingdom company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss of the Group for that period. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for the system of internal control, 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.

Independent auditors' report

to the Members of Network Rail Infrastructure Limited

We have audited the financial statements of Network Rail Infrastructure Limited for the year ended 31 March 2005 which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the balance sheets, the consolidated cash flow statement, and the related notes 1 to 31. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the Directors' Remuneration Report that is described as having been audited.

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

Respective responsibilities of Directors and auditors

As described in the statement of Directors' responsibilities, the Company's Directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the Annual Report including the Directors' Remuneration Report. Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report described as having been audited are properly prepared in accordance with the Companies Act 1985. We also report if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions with the Company and other members of the Group is not disclosed.

The Directors have also asked us to review whether the Corporate Governance Report reflects the Company's compliance with the nine provisions of the July 2003 FRC Combined Code specified for our review as if the listing rules of the Financial Services Authority applied, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the Directors' Report and the other information contained in the Annual Report for the above year as described in the contents section including the unaudited part of the Directors' Remuneration Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report described as having been audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 March 2005 and of the loss of the Group for the year then ended; and
- the financial statements and the part of the Directors' Remuneration Report described as having been audited have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
26 May 2005

Consolidated profit and loss account

for the year ended 31 March 2005

	Notes	2005 Before exceptional items £m	2005 Exceptional items (note 5) £m	2005 Total £m	2004 Before exceptional items £m	2004 Exceptional items (note 5) £m	2004 Total £m
Turnover	2	3,800	–	3,800	2,606	–	2,606
Operating costs	4	(3,340)	(53)	(3,393)	(3,207)	(157)	(3,364)
Operating profit/(loss)	5	460	(53)	407	(601)	(157)	(758)
Profit on sale of properties		69	–	69	40	–	40
Net interest payable	8	(640)	–	(640)	(352)	–	(352)
Loss on ordinary activities before taxation		(111)	(53)	(164)	(913)	(157)	(1,070)
Tax credit on loss on ordinary activities	9	14	16	30	298	38	336
Loss on ordinary activities after taxation and retained loss for the financial year	23	(97)	(37)	(134)	(615)	(119)	(734)

All amounts in the current and prior year relate to continuing activities.

Consolidated statement of total recognised gains and losses

for the year ended 31 March 2005

	Note	2005 £m	2004 £m
Loss for the financial year		(134)	(734)
Unrealised revaluation of the railway network	11	1,749	2,571
Unrealised revaluation of investment properties	11	10	7
Total gains and losses recognised for the year		1,625	1,844

Historical cost profits and losses are disclosed in note 24 to the financial statements.

Balance sheets

31 March 2005

	Notes	2005 Group £m	2004 Group £m	2005 Company £m	2004 Company £m
Fixed assets					
Intangible fixed assets	10	**79**	81	**–**	–
Tangible fixed assets	11	**23,094**	18,576	**23,094**	18,560
Investments	12	**–**	–	**49**	49
		23,173	18,657	**23,143**	18,609
Current assets					
Stocks	13	**62**	77	**62**	77
Debtors: amounts falling due within one year	14	**565**	659	**706**	850
Debtors: amounts falling due after more than one year	14	**332**	28	**332**	28
		897	687	**1,038**	878
Current asset investments	15	**192**	147	**25**	5
Cash at bank and in hand		**2**	8	**1**	8
		1,153	919	**1,126**	968
Creditors: amounts falling due within one year	16	**(7,217)**	(7,065)	**(7,170)**	(7,066)
Net current liabilities		**(6,064)**	(6,146)	**(6,044)**	(6,098)
Total assets less current liabilities		**17,109**	12,511	**17,099**	12,511
Creditors: amounts falling due after more than one year	17	**(11,578)**	(8,550)	**(11,576)**	(8,550)
Provisions for liabilities and charges	19	**(314)**	(369)	**(314)**	(369)
Net assets		**5,217**	3,592	**5,209**	3,592
Capital and reserves					
Called-up share capital	21	**160**	160	**160**	160
Share premium account	22	**85**	85	**85**	85
Revaluation reserve	22	**5,671**	3,917	**5,671**	3,917
Other reserves	22	**1,209**	1,209	**1,209**	1,209
Profit and loss account	22	**(1,908)**	(1,779)	**(1,916)**	(1,779)
Shareholders' funds		**5,217**	3,592	**5,209**	3,592
Attributable to equity shareholders		**5,057**	3,432	**5,049**	3,432
Attributable to non-equity shareholders		**160**	160	**160**	160

These financial statements were approved by the Board of Directors on 26 May 2005.

Signed on behalf of the Board of Directors:

John Armitt Director

Ron Henderson Director

Consolidated cash flow statement

for the year ended 31 March 2005

	Notes	2005 £m	2004 £m
Net cash inflow from operating activities	27	**980**	1,078
Returns on investments and servicing of finance			
Interest received		**23**	7
Interest paid		**(498)**	(428)
Net cash outflow from returns on investments and servicing of finance		**(475)**	(421)
Capital expenditure			
Purchase of tangible and intangible fixed assets		**(3,528)**	(3,844)
Sale of tangible fixed assets		**74**	40
Capital element of finance lease receipts		**3**	7
Capital grants received		**93**	41
Net cash outflow from capital expenditure		**(3,358)**	(3,756)
		(2,853)	(3,099)
Management of liquid resources			
(Purchase)/sale of short-term investments		**(45)**	31
Financing			
New loans		**4,055**	10,351
Capital element of finance leases repaid		**(31)**	–
Repayment of loans		**(1,132)**	(7,283)
Net cash inflow from financing		**2,892**	3,068
Decrease in cash in the year	28 & 29	**(6)**	–

Notes to the financial statements

for the year ended 31 March 2005

1 Basis of preparation and accounting policies

Principal accounting policies

The financial statements have been prepared in accordance with applicable United Kingdom accounting standards. The principal accounting policies adopted have been applied consistently in both the current and prior year and are described below.

Accounting convention and basis of consolidation

The financial statements have been prepared under the historical cost convention as modified by the revaluation of the railway network to the lower of its depreciated replacement cost (DRC) and value in use and the revaluation of investment properties to open market value.

The consolidated financial statements incorporate the financial statements of the Company and all of its subsidiaries.

Turnover

Turnover represents amounts due for the year derived from the management and provision of assets for the use in the operation of a railway, property rental income, and the sale of commercial and development properties net of value added tax, and takes account of any performance penalties or bonuses in respect of the year.

Performance regimes

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

Tangible fixed assets

Fixed assets – the railway network

The railway network is valued at depreciated replacement cost. A revaluation of the assets that comprise the railway network and an assessment of their estimated remaining weighted average useful economic lives is performed annually with external verification of the valuation and asset lives carried out, where required at least every five years.

The railway network is written down in the financial statements to its value in use where there has been an impairment in value.

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 25 years.

Investment properties

Investment properties comprise offices and other non-specialist properties that are not occupied by the Company where the interest is completely separable from the railway infrastructure, and which are held for their investment potential. Investment properties are revalued at each year end in accordance with SSAP19, "Accounting for Investment Properties". Any surplus or deficit on revaluation is transferred to the revaluation reserve unless a deficit below original cost, or its reversal, on an individual investment property is expected to be permanent, in which case it is recognised in the profit and loss account for the year.

No depreciation is provided in respect of freehold investment properties or leasehold investment properties with over 20 years to expiry. This is a departure from the requirements of the Companies Act 1985 which requires all properties to be depreciated.

The Directors consider that this accounting policy results in the financial statements giving a true and fair view. Such properties are held for investment and not for consumption. The Directors consider that to depreciate them would not give a true and fair view. Depreciation is one of many factors reflected in the annual valuation and the amount that might otherwise have been shown cannot be separately identified or quantified.

Intangible fixed assets

Intangible fixed assets are valued at cost on acquisition and are amortised in equal annual amounts over their estimated useful life. Concessions are amortised over the length of the underlying contractual agreement.

Notes to the financial statements

for the year ended 31 March 2005

1 Basis of preparation and accounting policies continued

Fixed asset investments

Fixed asset investments including investments in subsidiaries are stated at cost less provision for impairment.

Grants

Grants and other contributions received towards the cost of tangible fixed assets are included in creditors as deferred income and credited to the profit and loss account over the estimated useful economic life of the asset. Revenue grants earned for the management and provision of railway network assets are credited to the profit and loss account in the period to which they relate.

Deferred taxation

Deferred taxation is provided on timing differences arising from the different treatments for accounts and taxation purposes of transactions and events recognised in the financial statements of the current year and previous years. Deferred taxation is calculated at the rates at which it is estimated that tax will arise. Deferred taxation is not discounted.

Deferred taxation is not provided in respect of timing differences arising from the sale or revaluation of fixed assets unless, by the balance sheet date, a binding commitment to sell the asset has been entered into and it is unlikely that any gain will be rolled over.

Long-term contracts

Long-term contract work in progress is stated at cost plus, where the outcome can be assessed with reasonable certainty, estimated profits attributable to the state of completion, less provision for any known or anticipated losses and progress payments receivable on account. Contract provisions in excess of amounts recoverable are included in provisions for liabilities and charges.

Advance and progress payments are included under creditors to the extent that they exceed the related work in progress. Work in progress is shown within stocks, except where it includes attributable profit, when it is shown under debtors as amounts recoverable under contracts.

Stocks

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

Current asset investments

Current asset investments are stated at the lower of cost and net realisable value.

Leases

The net investment in assets leased to third parties is included in debtors. Income from finance leases is allocated to accounting periods so as to give a constant rate of return on the net investment in the lease.

Assets obtained under finance leases and hire purchase contracts are included in tangible fixed assets. The finance charges are allocated over the period of the lease in proportion to the capital element outstanding. Operating lease rentals are charged to income in equal annual amounts over the lease term.

Pension costs

The expected cost of providing pensions, as calculated periodically by professionally qualified actuaries, is charged to the profit and loss account so as to spread the cost over the service lives of employees in the scheme in such a way that the pension cost is a substantially level percentage of current and expected future pensionable payroll. Differences between the amount charged to the profit and loss account and payments made to schemes are treated as assets or liabilities in the balance sheet. Further details are given in note 7 to the financial statements.

Research and development

Research and general development expenditure is charged to the profit and loss account as incurred.

Expenditure on the development of specific projects is carried forward when its recoverability can be foreseen with reasonable certainty.

Debt

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

1 Basis of preparation and accounting policies continued

Derivative financial instruments

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

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

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

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

Capitalised interest

Interest is capitalised during the period of construction on all projects to the extent that the project is not financed by the contractor. The average rate used during the year was 4.95% (2003/04: 4.09%).

Foreign exchange

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

Property clawback

Train operating companies were entitled to a share of any property gains and income up to 31 March 2004 (above certain thresholds). The total clawback is allocated between the profit and loss account and the statement of total recognised gains and losses according to the treatment of the excess gains.

2 Turnover

	2005 £m	2004 £m
Passenger franchise revenue	**1,435**	1,899
SRA revenue grants	**2,058**	452
Freight revenue	**73**	68
Property rental income	**172**	167
Other income	**62**	20
	3,800	2,606

All turnover relates to the UK.

All turnover and losses arose from, and all assets relate to, the Group's principal activity, the management of the national rail infrastructure.

Notes to the financial statements

for the year ended 31 March 2005

3 Performance regimes

The net effect of the performance regimes on the results of the Group for the year was as follows:

	2005 £m	2004 £m
Included in turnover		
Access charge supplements	**89**	48
Net penalty receivable/(payable) from/(to) customers	**13**	(396)
	102	(348)

4 Operating costs

	2005 Before exceptional items £m	2005 Exceptional items (note 5) £m	2005 Total £m	2004 Before exceptional items £m	2004 Exceptional items (note 5) £m	2004 Total £m
Employee costs (note 6)	**1,129**	**3**	**1,132**	647	–	647
Own work capitalised	**(334)**	**–**	**(334)**	(283)	–	(283)
Capital grants amortised	**(27)**	**–**	**(27)**	(10)	–	(10)
Other external charges	**1,869**	**50**	**1,919**	2,311	105	2,416
Depreciation and other amounts written off tangible fixed assets	**834**	**–**	**834**	643	52	695
Other operating income	**(131)**	**–**	**(131)**	(101)	–	(101)
	3,340	**53**	**3,393**	3,207	157	3,364

Included within operating costs are infrastructure maintenance costs of £1,402m (2003/04: £1,408m).

5 Operating profit/(loss)

	2005 £m	2004 £m
Operating profit/(loss) is stated after charging:		
Rentals under operating leases		
Plant and machinery	**21**	5
Other	**74**	72
Research and development	**3**	2
Depreciation and other amounts written off tangible fixed assets	**834**	695
Amortisation of intangible fixed assets	**2**	1
Auditors' remuneration		
Statutory audit services	**0.4**	0.4
Other compliance work	**0.1**	0.1
Other non-audit fees	**0.1**	0.2
Exceptional items		
Transitional reorganisation costs	**53**	105
West Coast Route Modernisation abortive costs	**–**	52
	53	157

6 Employees

	2005 £m	2004 £m
Employee costs during the year (including Directors)		
Wages and salaries	933	532
Social security costs	82	48
Pension costs	117	67
	1,132	647

	Number	Number
Average number of persons employed		
Management and operation of railway	26,433	15,015
Number of persons employed		
At 31 March	29,638	16,574

Included within the total employee cost above is the remuneration of the Directors totalling £3.7m (2003/04: £3.3m) details of which can be found within the Directors' Remuneration Report on pages 20 and 21.

7 Pension costs

The principal pension scheme in which the Group participates is the Railways 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.

The Network Rail Section of the RPS was closed to new employees from 1 April 2004. Benefits for existing members and employees joining up to and including 31 March 2004 were not affected by the closure of the Network Rail Section. In addition to closing the scheme to new entrants the Company has capped its contribution to British Railways Additional Superannuation Scheme (BRASS) matching at current levels for existing employees' contributions. The Company will continue to match regular contributions but will not increase them in cash terms in the future.

With effect from 1 April 2004 the Company introduced a defined contribution pension scheme, the Network Rail Defined Contribution Pension Scheme (NRDCPS). This scheme is the only Company-sponsored pension offered to all new employees of Network Rail, except those who have the legal right to join the RPS. Any employee who wishes to transfer from the Network Rail Section of the RPS to the NRDCPS is entitled to do so.

All employees that joined the NRDCPS have the option to join the Network Rail Section of the RPS upon completion of five years' continuous service with the Company.

During the year the Company completed the process of bringing all infrastructure maintenance contracts in-house, resulting in 10,091 employees joining the Network Rail Section of the RPS in the year to 31 March 2005. This is in addition to the 2,374 employees who joined from maintenance contractors in the year to 31 March 2004. Infrastructure maintenance contractors who were in their employer's section of the RPS were given the option to transfer their accrued benefits into the Network Rail Section of the RPS. Transferring employees that were not members of the RPS in their previous employer's section were offered membership of the NRDCPS.

A full actuarial valuation of the Network Rail Section was carried out by the scheme actuary at 31 December 2001. A valuation for accounting purposes was carried out at 31 December 2004 and adjusted to 31 March 2005 by the Group's pension adviser, a qualified independent actuary.

Notes to the financial statements

for the year ended 31 March 2005

7 Pension costs continued

This accounting valuation has resulted in a significant increase in the FRS 17 scheme deficit compared to the position at 31 March 2004. This is principally due to increased members' life expectancy and allowances for BRASS commutation on retirement.

Based on the accounting valuation of 31 December 2004 adjusted to 31 March 2005, the Group's pension charge for the year ended 31 March 2005 was £117m (2003/04: £67m). The pension provision as at 31 March 2005 is £101m (2004: £59m).

Full details of the scheme deficit and the share recognised by the Company are given in the FRS17 disclosures below.

The scheme actuary is currently carrying out a full actuarial funding valuation as at 31 December 2004, the results of which will be available in the third quarter of 2005. Following this formal valuation, the future contributions to the Section will be determined with the Trustees of the RPS, the Network Rail Pensions Committee and the Company.

The total contribution rate payable under the RPS is split in the proportion 60:40 between the Group and the members. At the start of the year, the Group and members were paying contributions of 14.25% and 8.0% of section pay respectively. With effect from 1 January 2005 the members' rate changed to 9.5%. These rates were determined following the funding valuation carried out by the scheme actuary as at 31 December 2001. If a surplus or deficit arises, the provisions in the RPS rules require that the Company meets the shortfall in respect of preserved benefits in full (if the liability for preserved benefits exceeds 2.5% of the total deficit) with the contributions to fund the remainder of the deficit split between the Company and the members in the proportion 60:40.

The independent actuary has assessed the charge in respect of pension provision for the Group using the following market-related assumptions.

The principal assumptions used in establishing the pension cost for the year were inflation of 2.90% per annum, an investment return of 5.40% per annum and pay inflation of 4.40% per annum. Assets have been taken at market value. Liabilities and the contribution rate have been assessed using the projected unit credit method. The Network Rail Section's funding level was assessed on this basis to be 73.4% of its liabilities as at 31 March 2005.

FRS17 pension disclosures

The pension cost figures in these financial statements comply with the current pension cost accounting standard SSAP24, "Accounting for Pension Costs". A new pension cost accounting standard, FRS17, "Retirement Benefits", must be used for the figures that will be shown in the financial statements for the year ended 31 March 2006 and subsequent years. Under transitional arrangements the Group is required to disclose the following information about the scheme and the figures that would have been shown under FRS17 in the current balance sheet, profit and loss account and statement of total recognised gains and losses.

A full actuarial valuation of the approved scheme was carried out at 31 December 2001 and adjusted to 31 March 2005 for FRS17 disclosure purposes by a qualified independent actuary.

The major assumptions used by the actuary were (in nominal terms):

	At 31 March 2005 % pa	At 31 March 2004 % pa	At 31 March 2003 % pa
Real rate of increase in salaries	**4.40**	4.65	5.10
Rate of increase to pensions in payment	**2.90**	2.90	2.60
Discount rate	**5.40**	5.50	5.40
Inflation assumption	**2.90**	2.90	2.60

7 Pension costs continued

The assets in the scheme and the expected rate of return calculated on the basis of the above assumptions by the independent actuary were:

	Long-term rate of return expected at 31 March 2005 %	Value at 31 March 2005 £m	Long-term rate of return expected at 31 March 2004 %	Value at 31 March 2004 £m	Long-term rate of return expected at 31 March 2003 %	Value at 31 March 2003 £m
Equities	**6.25**	**1,293**	6.35	996	6.12	759
Bonds	**4.25**	**410**	4.35	177	4.12	103
Property	**6.25**	**152**	6.35	85	6.12	75
Total market value of assets		**1,855**		1,258		937
Present value of scheme liabilities		**(2,527)**		(1,525)		(1,430)
Deficit in the scheme		**(672)**		(267)		(493)
Company's share of the deficit		**(410)**		(160)		(296)
Related deferred tax asset		**123**		48		89
Net pension liability		**(287)**		(112)		(207)

If the entire pension liability was recognised in the financial statements, the Group's net assets and profit and loss reserve would be as follows:

	Value at 31 March 2005 £m	Value at 31 March 2004 £m
Net assets excluding SSAP24 pension liability	**5,318**	3,651
Net FRS17 pension liability	**(287)**	(112)
Net assets including FRS17 pension liability	**5,031**	3,539
Profit and loss reserve excluding SSAP24 pension liability	**(1,807)**	(1,720)
Net FRS17 pension liability	**(287)**	(112)
Profit and loss reserve including FRS17 pension liability	**(2,094)**	(1,832)

Analysis of amount that would have been charged in the profit and loss account:

	2005 £m	2004 £m
Current service cost	**89**	54
Past service cost	**–**	–
Total charge to operating profit	**89**	54
Expected return on pension scheme assets	**89**	57
Interest on pension scheme liabilities	**(96)**	(79)
Total charge to net finance cost	**(7)**	(22)

Notes to the financial statements

for the year ended 31 March 2005

7 Pension costs continued

Analysis of the amount that would have been recognised in the statement of total recognised gains and losses:

	2005 £m	2004 £m
Actual return less expected return on assets	80	203
Experience gains and losses on liabilities	(217)	–
Changes in assumptions	(247)	50
Change in expected employee contribution towards shared cost of deficit	155	(90)
Actuarial (loss)/gain	(229)	163
Movement in deficit in the year		
Deficit in scheme at beginning of the year	(160)	(296)
Current service cost	(89)	(54)
Contributions	75	49
Net finance cost	(7)	(22)
Actuarial (loss)/gain	(229)	163
Company's share of the deficit in the scheme at end of the year	(410)	(160)

History of experience gains and losses:

	2005 £m	2004 £m	2003 £m
Difference between expected and actual return on scheme assets	80	203	(360)
Percentage of scheme assets	4.3%	16.1%	(38.4)%
Experience gains and losses	(217)	–	–
Percentage of scheme liabilities	(8.6)%	0%	0%
Total amount recognised in the statement of total recognised gains and losses	(229)	163	(189)
Percentage of scheme liabilities	(9.1)%	10.7%	(13.2)%

8 Net interest payable

	2005 £m	2004 £m
Interest payable and similar charges		
On bank loans and overdrafts	57	55
Interest paid on loan from immediate parent company	53	265
Interest paid on loans from other Group companies	180	97
On debt issued under Medium Term Note Programme	349	3
On debt issued under Debt Issuance Programme	68	–
On other loans	26	18
Total	733	438
Interest capitalised	(70)	(72)
	663	366
Interest receivable	(23)	(14)
Net interest payable	640	352

9 Tax credit on loss on ordinary activities

	2005 £m	2004 £m
Analysis of credit in the year		
Current UK corporation tax at 30%:	–	–
Total current tax credit	–	–
Deferred tax at 30%:		
Credit in respect of prior years	45	98
(Debit)/credit for timing differences arising in the year	(15)	238
Total deferred tax	30	336
Tax credit on loss on ordinary activities	30	336

Factors affecting the current tax credit for the year
The tax for the year is lower than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	2005 £m	2004 £m
Loss on ordinary activities before tax	(164)	(1,070)
Loss on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2003/04: 30%)	(49)	(321)
Accelerated capital allowances	(288)	(249)
Tax losses carried forward	252	493
Tax losses carried back	–	7
Short-term timing differences	20	(6)
Permanent differences	65	76
Total current tax credit	–	–

10 Intangible fixed assets

	Concessions £m
Cost	
At 1 April 2004 and 31 March 2005	83
Accumulated amortisation	
At 1 April 2004	(2)
Charge for the year	(2)
At 31 March 2005	(4)
Net book value	
At 31 March 2005	79
At 31 March 2004	81

Notes to the financial statements

for the year ended 31 March 2005

11 Tangible fixed assets: Group and Company

	At 1 April 2004 £m	Additions £m	Disposals £m	Depreciation charge for the year £m	Revaluation during the year £m	At 31 March 2005 £m
The railway network at valuation	18,498	3,598	–	(834)	1,749	**23,011**
Investment properties at valuation	78	–	(5)	–	10	**83**
	18,576	3,598	(5)	(834)	1,759	**23,094**

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

In accordance with accounting standards Ove Arup and Partners have carried out an interim review in the current year of the Company's engineering assessment of the replacement cost, depreciated replacement cost and useful economic lives of the railway network assets. This interim review updated the above full review carried out in the year ended 31 March 2003. Ove Arup and partners have confirmed in writing that the basis upon which the assessment has been prepared continues to be appropriate and there have been no material changes to the valuations and estimates derived in the year ended 31 March 2003. A full review of the valuation and asset lives will be prepared and externally verified at least every five years.

The depreciated replacement cost of the railway network materially exceeds its value in use and has therefore been impaired down to its value in use (which primarily comprises the discounted future cash flows expected to arise from the Regulatory Asset Base).

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

The depreciation charge for any year is calculated using the average fixed asset net book value for the year and the estimated weighted average remaining useful economic life of the railway network. The estimated remaining weighted average useful economic life of the network is currently 25 years.

As at 31 March 2005 and 31 March 2004, the comparable net book value of the railway network according to the historic cost convention could not be accurately determined as the historic cost information is not available.

Similarly it is not possible to identify the undepreciated capitalised interest or the undepreciated assets held under finance leases, within the net book value of fixed assets. The amount of interest capitalised in the current and prior year is shown in note 8.

The freehold, heritable, feuhold and long leasehold investment properties were valued as at 31 March 2005 at £83m (31 March 2004: £78m). The valuations were undertaken on the basis of open market value in accordance with the appraisal and valuation manual of the Royal Institution of Chartered Surveyors. External valuers CB Richard Ellis valued 11 of the 63 investment properties (representing 86% by value of the portfolio). The remaining properties were valued by the Head of Commercial Property, Railway Estates (Network Rail), a chartered surveyor.

As at 31 March 2005, the comparable amount of the investment properties according to the historical cost convention is £13m (31 March 2004: £13m).

12 Investments: Company

	At cost £m
Investments in subsidiaries at 1 April 2004 and 31 March 2005	**49**

Directly owned subsidiaries	Country *of incorporation*	Proportion of all classes *of issued share capital owned*	Principal *activity*
Network Rail Insurance Limited	Guernsey	100%	Insurance
Network Rail (CTRL) Limited	England	100%	Holds St Pancras concession and CTRL Railway Services Agreement
Network Rail (Spacia) Limited	England	100%	Property letting
Network Rail (Stations) Limited	England	100%	Dormant
Network Rail (Projects) Limited	England	100%	Dormant
Network Rail (Property) Limited	England	100%	Dormant
Spacia (2002) Limited	England	100%	Dormant
Network Rail Defined Contribution Pension Scheme Trustee Limited	England	Company limited by guarantee	Administration of defined contribution pension scheme
Shares held by a trustee – quasi-subsidiaries			
Network Rail MTN Finance PLC	England	Shares held by HSBC Trustee (C.I.) Limited	Administration of Medium Term Note Programme
Network Rail Infrastructure Finance PLC	England	Shares held by HSBC Trustee (C.I.) Limited	Administration of Debt Issuance Programme

The external debt held by each of the quasi-subsidiaries is disclosed in notes 16 and 17. External interest payable is disclosed in note 8.

13 Stocks

	2005 Group and Company £m	2004 Group and Company £m
Raw materials and consumables	**35**	48
Properties in the course of development	**–**	1
Long-term contract balances		
Net cost	**29**	35
Applicable payments on account	**(2)**	(7)
	62	77

Notes to the financial statements

for the year ended 31 March 2005

14 Debtors

	2005 Group £m	2004 Group £m	2005 Company £m	2004 Company £m
Amounts falling due within one year				
Trade debtors	147	131	146	129
Capital grants receivable	24	3	24	3
Other debtors	119	231	267	427
Prepayments and accrued income	272	291	266	288
Net investment in finance leases	3	3	3	3
	565	659	706	850
Amounts falling due after more than one year				
Loan to immediate parent company	307	–	307	–
Net investment in finance leases	25	28	25	28
	332	28	332	28
	897	687	1,038	878
Net investment in finance leases comprises:				
Total lease payments receivable	39	45	39	45
Less: finance charges allocated to future periods	(11)	(14)	(11)	(14)
	28	31	28	31

Aggregate rentals receivable in respect of finance leases for the Group and Company were £6m (2003/04: £10m).

15 Current asset investments

	2005 Group £m	2004 Group £m	2005 Company £m	2004 Company £m
Short-term liquid investments including money market deposits	192	147	25	5

16 Creditors: Amounts falling due within one year

	2005 Group £m	2004 Group £m	2005 Company £m	2004 Company £m
Bank loans and overdrafts (see note 18)	**162**	37	**24**	37
Debt issued under Medium Term Note Programme (less unamortised discount) (see note 18)	**999**	–	**–**	–
Loan from immediate parent company (see note 18)	**–**	949	**–**	949
Loans from other Group companies (see note 18)	**3,961**	3,926	**5,098**	3,926
Payments received on account	**40**	47	**40**	47
Trade creditors	**543**	583	**536**	579
Taxation and social security	**37**	27	**37**	27
Other creditors	**124**	106	**124**	112
Interest due on loan to immediate parent company	**–**	16	**–**	16
Other interest accruals	**85**	27	**85**	27
Other accruals and deferred income	**1,266**	1,347	**1,226**	1,346
	7,217	7,065	**7,170**	7,066

17 Creditors: Amounts falling due after more than one year

	2005 Group £m	2004 Group £m	2005 Company £m	2004 Company £m
Bank loans	**1,352**	1,377	**1,352**	1,377
Debt issued under Medium Term Note Programme (less unamortised discount)	**5,709**	6,425	**–**	–
Debt issued under Debt Issuance Programme (less unamortised discount and fees)	**3,647**	–	**–**	–
Loans from other Group company	**–**	–	**9,356**	6,425
Finance leases and hire purchase contracts	**10**	41	**10**	41
Capital grants deferred income	**725**	639	**723**	639
SRA deferred development income	**135**	63	**135**	63
Other accruals and deferred income	**–**	5	**–**	5
	11,578	8,550	**11,576**	8,550

Bank loans falling due after more than one year are analysed as follows:

	2005 Group and Company £m	2004 Group and Company £m
HSBC Bank due 2017 repayable by instalments	**211**	217
Barclays Bank due 2017 repayable by instalments	**59**	60
Royal Bank of Scotland due 2017 repayable by instalments	**67**	70
European Investment Bank due 2007	**100**	100
6.42% European Investment Bank due 2009	**100**	100
6.42% European Investment Bank due 2011	**100**	100
5.77% European Investment Bank due 2012	**300**	300
5.57% European Investment Bank due 2013	**200**	200
Kreditanstalt für Wiederaufbau due 2013 repayable by instalments	**115**	130
Kreditanstalt für Wiederaufbau due 2015 repayable by instalments	**100**	100
	1,352	1,377

Notes to the financial statements

for the year ended 31 March 2005

17 Creditors: Amounts falling due after more than one year continued

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

	2005 Group £m	2004 Group £m	2005 Company £m	2004 Company £m
Amounts falling due in more than one year:				
4⅞% sterling Medium Term Note due 2009				
(less unamortised discount)	**2,239**	2,235	–	–
2⅝% US dollar Medium Term Note due 2008				
(less unamortised discount)	**686**	685	–	–
3⅛% euro Medium Term Note due 2009				
(less unamortised discount)	**1,670**	1,668	–	–
Floating rate sterling Medium Term Note due 2006				
(less unamortised discount)	**–**	999	–	–
Floating rate euro Medium Term Note due 2007				
(less unamortised discount)	**838**	838	–	–
2⅝% US dollar Medium Term Note due 2008	**276**	–	–	–
	5,709	6,425	–	–
Amounts falling due in less than one year:				
Floating rate sterling Medium Term Note due 2006				
(less unamortised discount)	**999**	–	–	–
	6,708	6,425	–	–

Debt issued under Debt Issuance Programme is analysed as follows:

	2005 Group £m	2004 Group £m	2005 Company £m	2004 Company £m
4.75% sterling bond due 2035				
(less unamortised discount and fees)	**1,218**	–	–	–
4.875% sterling bond due 2015				
(less unamortised discount and fees)	**738**	–	–	–
1.9618% sterling index linked bond due 2025				
(less unamortised discount and fees)	**249**	–	–	–
1.5646% sterling index linked bond due 2044				
(less unamortised discount and fees)	**196**	–	–	–
3.875% US dollar bond due 2009				
(less unamortised discount and fees)	**529**	–	–	–
4.75% sterling bond due 2024				
(less unamortised discount and fees)	**717**	–	–	–
	3,647	–	–	–

18 Financial instruments

The Group's funding and treasury operations ("Treasury") are co-ordinated and managed in accordance with policies and procedures approved by the Board. Treasury is subject to regular internal audits and does not engage in trades of a speculative nature.

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

The Group has a policy of immediately hedging all identified foreign exchange exposures over £250,000 or equivalent.

Unless specifically stated, the following disclosures exclude short-term debtors and creditors and are at book value. Debts are analysed by repayment date.

	2005 Group £m	2004 Group £m
Due within one year		
Bank loans and overdrafts	**162**	37
Loan from immediate parent company	**–**	949
Loan from other Group company	**3,961**	3,926
Debt issued under Medium Term Note Programme	**999**	–
	5,122	4,912
Due within one to two years		
Bank loans and overdrafts	**35**	24
Debt issued under Medium Term Note Programme	**838**	999
Finance leases and hire purchase contracts	**–**	1
	873	1,024
Due within two to five years		
Bank loans and overdrafts	**317**	312
Debt issued under Medium Term Note Programme	**4,871**	5,426
Debt issued under Debt Issuance Programme	**529**	–
Finance leases and hire purchase contracts	**1**	2
	5,718	5,740
Due after five years		
Bank loans and overdrafts (£400m repayable by instalments (2004: £441m))	**1,000**	1,041
Debt issued under Debt Issuance Programme	**3,118**	–
Finance leases and hire purchase contracts (repayable by instalments)	**9**	38
	4,127	1,079
Total		
Bank loans and overdrafts	**1,514**	1,414
Loan from immediate parent company	**–**	949
Loan from other Group company	**3,961**	3,926
Debt issued under Medium Term Note Programme	**6,708**	6,425
Debt issued under Debt Issuance Programme	**3,647**	–
Finance leases and hire purchase contracts	**10**	41
	15,840	12,755

18 Financial instruments continued

Interest rates on borrowings

The interest rate exposure on gross borrowings at 31 March 2005 and 2004 was:

	Floating rate borrowings £m	Fixed rate borrowings £m	Total £m	Fixed borrowings: Weighted average interest rate %	Fixed borrowings: Weighted average time for which rate is fixed Years
2005	4,455	11,385	**15,840**	5.17	9.1
2004	9,820	2,935	**12,755**	5.12	5.7

All borrowings are denominated in or swapped into sterling. The floating rate borrowings are all referenced to London Inter Bank Offered Rate (LIBOR).

To protect further against movements in interest rates the Group has also entered into a number of forward starting sterling denominated interest rate swaps which have a notional amount of £1.5bn (2004: £3bn).

Interest rates on other financial liabilities

The Group has £nil (31 March 2004: £5m) of long-term non interest bearing financial liabilities for which the weighted average period to maturity is nil years (31 March 2004: 1.5 years).

Investment in financial assets

Interest bearing assets at 31 March 2005 and 2004 were:

	Floating rate investments £m	Fixed rate investments £m	Total £m	Financial assets with fixed rates: Weighted average interest rate %	Financial assets with fixed rates: Weighted average time for which rate is fixed Years
2005	64	158	**222**	5.20	3.1
2004	24	162	**186**	5.14	2.7

The rates achieved on the above floating rate investments are set at the time of investment with reference to indices such as LIBOR.

Included in the above analysis are assets belonging to Network Rail Insurance Limited of £167m (31 March 2004: £142m). Not included in the above analysis are monies held in escrow client accounts of £0.4m (31 March 2004: £0.3m).

The Group has no long-term non interest bearing financial assets (31 March 2004: £nil).

Committed facilities

At 31 March 2005 and 2004 the Group had the following undrawn committed facilities:

	2005 Drawn £m	2005 Undrawn £m	2005 Total £m	2004 Drawn £m	2004 Undrawn £m	2004 Total £m
Bridge facility from immediate parent company	–	–	–	949	4,302	5,251
Working capital facility	**138**	**3,362**	**3,500**	–	–	–
SRA standby facility A	–	**4,000**	**4,000**	–	4,000	4,000
	138	**7,362**	**7,500**	949	8,302	9,251

18 Financial instruments continued

Undrawn committed borrowing facilities expire as follows:

	2005 £m	2004 £m
Within one year	3,362	4,302
Within one to two years	–	–
In more than two years	4,000	4,000
	7,362	8,302

Not included in the above analysis are the £800m European Investment Bank and £230m Kreditanstalt für Wiederaufbau facilities as these were fully drawn as at 31 March 2005.

In addition, the SRA has provided support facilities in respect of the facilities listed below:

- Unlimited financial indemnity in respect of borrowings under the Debt Issuance Programme
- Medium Term Note Programme
- £4.0bn Commercial Paper Programme
- £800m European Investment Bank
- £230m Kreditanstalt für Wiederaufbau

The support facilities provided by the SRA cover amounts payable under the relevant facilities.

A £1bn liquidity facility is provided by a consortium of banks in support of the £4bn Commercial Paper Programme.

Uncommitted facilities
The Group has a £25m overdraft facility and a £25m money market line with its clearing bank.

Fair value
A comparison of current and book values of all the Group's financial instruments at 31 March 2005 and 31 March 2004 is provided below.

	2005 Book value £m	2005 Fair value £m	2004 Book value £m	2004 Fair value £m
Assets/(liabilities)				
Interest-bearing financial assets	222	222	186	187
Debt securities and finance leases	(10)	(10)	(41)	(41)
Short-term borrowings and current portion of long-term debt	(162)	(162)	(986)	(986)
Loan from other Group company	(3,991)	(3,991)	(3,959)	(3.959)
Debt issued under Medium Term Note Programme (before unamortised discount)	(6,752)	(6,716)	(6,434)	(6.403)
Cross currency swaps to hedge debt issued under Medium Term Note Programme	20	(42)	(22)	(34)
Debt issued under Debt Issuance Programme (before unamortised discount)	(3,734)	(3,688)	–	–
Cross currency swaps to hedge debt issued under Debt Issuance Programme	(1)	(15)	–	–
Long-term bank loans	(1,352)	(1,397)	(1,377)	(1,423)
Forward starting interest rate swaps	–	(28)	–	(11)
Forward foreign currency contracts	(1)	(1)	(3)	(5)
Long-term non interest bearing financial liabilities	–	–	(5)	(5)

Notes to the financial statements

for the year ended 31 March 2005

18 Financial instruments continued

The assumptions used to estimate fair values of debt and other financial instruments are summarised below:

i) Listed investments are stated at fair value based on their market price at 31 March.
ii) The carrying values of cash and liquid investments approximate to their fair values because of the short-term maturity of these instruments.
iii) For short-term borrowings (uncommitted borrowing, commercial paper and short-term borrowings under the committed facilities) the book value approximates to fair value because of their short maturities.
iv) The fair values of all quoted eurobonds are based on their closing clean mid-market price converted at the spot rate of exchange as appropriate.
v) The fair values of the fixed rate EIB loans have been calculated by discounting their future cash flows at market rates.
vi) For floating rate loans and finance leases, the book value approximates to fair value because of frequent reset of interest rates.
vii) The fair values of foreign currency forward contracts are estimated using market forward exchange rates on 31 March.
viii) The fair values of the sterling interest rate swaps have been estimated by calculating the present value of estimated cash flows.
ix) The fair values of the cross currency interest rate swaps have been estimated by adding the present values of the two sides of each swap. The present value of each side of the swap is calculated by discounting the estimated future cash flows for that side, using the appropriate market discount rates for that currency in effect at the balance sheet date.

Gains and losses on hedges
The Group immediately enters into forward foreign currency contracts to eliminate the currency exposures (in excess of £250,000 equivalent) that arise on purchases denominated in foreign currencies as soon as the exposure is known. Changes in the fair value of instruments used as hedges are not recognised in the financial statements until the hedged position matures.

These gains and losses are anticipated to be recognised as follows:

	2005 Gains £m	2005 Losses £m	2005 Total net gains/ (losses) £m	2004 Gains £m	2004 Losses £m	2004 Total net gains/ (losses) £m
Unrecognised gains and losses on hedges at 1 April	1	(26)	(25)	3	–	3
Gains and losses arising in the prior year that were recognised in the current year	–	1	1	(2)	–	(2)
Gains and losses arising in the prior year that were not recognised in the current year	1	(25)	(24)	1	–	1
Gains and losses arising in the current year that were not recognised in the current year	10	(90)	(80)	–	(26)	(26)
Unrecognised gains and losses on hedges at 31 March	11	(115)	(104)	1	(26)	(25)
Of which:						
Gains and losses expected to be recognised within one year	3	(36)	(33)	1	(14)	(13)
Gains and losses expected to be recognised after more than one year	8	(79)	(71)	–	(12)	(12)

Currency analysis of net assets
All material net assets are in sterling.

Market and credit risk
The Group holds a mixture of fixed and floating rate debt. The Group is exposed to upward movements in interest rates because it has floating rate debt in excess of floating rate assets. Interest rate derivatives are used to hedge against rises in interest rates.

The Group is also exposed to credit risk. The Group invests surplus cash and undertakes derivative and foreign exchange transactions with approved counterparties. Each counterparty has a credit limit which is set based upon published credit ratings. These limits are designed to mitigate the concentration of credit risk. They are monitored on a regular basis.

19 Provisions for liabilities and charges: Group and Company

	1 April 2004 £m	Utilised in the year £m	Provision raised £m	31 March 2005 £m
Deferred tax (note 20)	182	(30)	–	**152**
Pension	59	(75)	117	**101**
Environmental liabilities	33	(11)	–	**22**
Other	95	(82)	26	**39**
	369	(198)	143	**314**

The Group and Company have provided for the anticipated costs of remedial works on land inherited from the British Railways Board which has suffered contamination, and where contractual or other obligations require the Company to clear up these sites. Following a review of the planned expenditure, it is estimated that the provision will be entirely utilised within two to three years. In addition, the Group and Company have provided against a number of commercial claims from third parties for which settlement is expected to be achieved in the next one to two years.

20 *Deferred taxation*

	£m
At 1 April 2004	182
Deferred tax credited to the profit and loss account	(30)
At 31 March 2005	152

	2005 £m	2004 £m
Accelerated capital allowances	**1,918**	1,377
Short-term timing differences	**(39)**	(19)
Tax losses carried forward	**(1,727)**	(1,176)
Provision for deferred tax	**152**	182

The current rate of corporation tax of 30% (2003/04: 30%) has been used to calculate the amount of deferred taxation. Provision has been made for all deferred taxation assets and liabilities in respect of accelerated capital allowances, short-term timing differences and tax losses carried forward, arising from transactions and events recognised in the financial statements of the current year and previous years.

The amounts of deferred taxation not provided in the financial statements are as follows:

	2005 £m	2004 £m
Rolled over gains	**238**	192
Revaluation of fixed assets	**1,703**	1,175
Deferred taxation not provided at 30% (2003/04: 30%)	**1,941**	1,367

The £238m (31 March 2004: £192m) of tax in respect of rolled over gains relates primarily to the gains realised by the British Railways Board which have been deferred through the application of capital gains rollover relief into assets vested in Railtrack PLC (now Network Rail Infrastructure Limited).

There is insufficient historical information to calculate the amount of unprovided deferred taxation in respect of the revaluation of fixed assets. However the potential maximum provision would be £1,703m (31 March 2004: £1,175m).

No provision has been made in respect of deferred taxation in relation to these gains as no liability is expected to arise.

Notes to the financial statements

for the year ended 31 March 2005

21 Called-up share capital

	2005 Number of shares	2005 £m	2004 Number of shares	2004 £m
Authorised				
Ordinary shares of 0.1p each	**50,200,000**	**–**	50,200,000	–
Redeemable shares of £1 each	**500,000,000**	**500**	500,000,000	500
		500		500
Called-up, allotted and fully paid				
Ordinary shares of 0.1p each	**50,084,937**	**–**	50,084,937	–
Redeemable shares of £1 each	**160,000,000**	**160**	160,000,000	160
		160		160

The Company has the option to repurchase any or all of the redeemable shares at any date after 31 March 2003. No premium is repayable on such redemption and the option to repurchase has no expiry date. The redeemable shareholders have no right to redemption at their instigation. Redeemable shares do not carry voting rights, or rank for dividend, but may do so if the Company passes a resolution to that effect. A condition of the sale of Railtrack PLC to Network Rail Limited was that Railtrack Group PLC would waive all rights to redemption of these shares once the transaction was completed.

22 Group reserves

	Revaluation reserve £m	Share premium £m	Other reserves £m	Profit and loss account £m	Total £m
At 1 April 2004	3,917	85	1,209	(1,779)	**3,432**
Unrealised revaluation of the railway network	1,749	–	–	–	**1,749**
Unrealised revaluation of investment properties	10	–	–	–	**10**
Transfer of revaluation surplus on disposal of investment properties	(5)	–	–	5	**–**
Retained loss for the financial year	–	–	–	(134)	**(134)**
At 31 March 2005	5,671	85	1,209	(1,908)	**5,057**

As permitted by Section 230 of the Companies Act 1985, the Company has not presented its profit and loss account. The loss for the Company for the year was £142m (2003/04: loss of £734m). In addition there was a transfer of £5m revaluation surplus from the revaluation reserve to the profit and loss account in the Company.

The revaluation reserve includes £70m relating to investment properties.

23 Reconciliation of movement in Group shareholders' funds

	2005 £m	2004 £m
Loss for the year	**(134)**	(734)
Unrealised revaluation of the railway network	**1,749**	2,571
Unrealised revaluation of investment properties	**10**	7
Net addition to shareholders' funds	**1,625**	1,844
Opening shareholders' funds	**3,592**	1,748
Closing shareholders' funds	**5,217**	3,592

24 Historical cost profits and losses

	2005 £m	2004 £m
Loss on ordinary activities before taxation	(164)	(1,070)
Reduction in profit on sale of properties on an historical cost basis	(3)	–
Realisation of property revaluation gains of previous years	5	–
Historical cost loss on ordinary activities before taxation	(162)	(1,070)
Historical cost loss for the year accumulated after taxation	(132)	(734)

The additional depreciation charge on an historical cost basis cannot be accurately determined as the information is not available.

25 Capital commitments

	2005 £m	2004 £m
Capital expenditure commitments contracted for (including the capital value of finance lease commitments) not provided for in these financial statements	883	2,298

26 Operating lease commitments

	2005 £m	2004 £m
Land and buildings		
Leases which expire:		
Within one year	7	1
Within two to five years	9	5
After five years	14	16
	30	22
Other		
Leases which expire:		
Within one year	6	41
Within two to five years	46	7
After five years	–	–
	52	48
Total		
Leases which expire:		
Within one year	13	42
Within two to five years	55	12
After five years	14	16
	82	70

Notes to the financial statements

for the year ended 31 March 2005

27 Reconciliation of operating profit/(loss) to net cash inflow from operating activities

	2005 £m	2004 £m
Operating profit/(loss)	**407**	(758)
Depreciation and amortisation (net of capital grants amortised)	**809**	686
Decrease/(increase) in stocks	**15**	(39)
(Increase)/decrease in debtors	**(192)**	1,033
(Decrease)/increase in creditors	**(34)**	104
(Decrease)/increase in provisions	**(25)**	52
Net cash inflow from operating activities	***980***	*1,078*

The cash outflow in respect of the exceptional operating items in the year was £47m (2003/04: £7m).

28 Analysis of changes in net debt

	At 1 April 2004 £m	Cash flows £m	Non cash movements £m	Amortisation of discount £m	At 31 March 2005 £m
Cash at bank and in hand	8	(6)	–	–	**2**
Borrowings due within one year	(4,912)	993	(1,022)	(181)	**(5,122)**
Borrowings due after one year	(7,843)	(3,885)	1,022	(12)	**(10,718)**
Current asset investments	147	45	–	–	**192**
	(12,600)	(2,853)	–	(193)	**(15,646)**

29 Reconciliation of net cash flow to movement in net debt

	2005 £m	2004 £m
Decrease in cash in the year	**(6)**	–
Cash inflow from increase in debt and lease financing	**(2,892)**	*(3,068)*
Cash outflow/(inflow) from increase/(decrease) in liquid resources	**45**	(31)
Change in net debt resulting from cash flows	**(2,853)**	(3,099)
Amortisation of discount	**(193)**	(97)
Movement in net debt in the year	**(3,046)**	(3,196)
Net debt at 1 April	**(12,600)**	*(9,404)*
Net debt at 31 March	**(15,646)**	(12,600)

30 Ultimate parent company and controlling entity

The Group's ultimate parent company and controlling entity is Network Rail Limited, a company limited by guarantee incorporated in Great Britain and registered in England and Wales. The largest and smallest group of undertakings of which the Company is a member and for which Group accounts are drawn up is Network Rail Limited. Copies of that company's financial statements can be obtained by contacting Network Rail Limited at 40 Melton Street, London NW1 2EE.

31 Related party transactions

During the year the Company met the exemption requirements of FRS8, "Related Party Transactions", in that 90% or more of its voting rights are controlled by Network Rail Limited. The Company has, therefore, not separately disclosed transactions with other Group companies and investments of the Group qualifying as related parties for that period.

The results of Network Rail Limited (the ultimate parent company) are consolidated by the SRA which is the only group of which the Company is a member. Transactions with the SRA include receipt of grant payments and rental payments for leasehold buildings.

Company information

Financial calendar 2005/06

31 March 2005	Publication of 2005 Business Plan
26 May 2005	Preliminary results announcement
20 July 2005	Annual General Meeting of Network Rail Limited in Birmingham
November 2005	Results for half year to 30 September 2005 announcement
31 March 2006	Publication of 2006 Business Plan

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