

Network Rail Infrastructure Limited

Financial statements

Year ended 31 March 2018

Company registration number 2904587

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Officers and professional advisers

Directors

Mark Carne
Rob Brighthouse
Richard Brown
Sharon Flood
Chris Gibb
Sir Peter Hendy
Silla Maizey
John Mogford – appointed 22 November 2016; resigned 31 January 2017
Michael O'Higgins
Mike Putnam – appointed 8 January 2018
Bridget Rosewell
Jeremy Westlake

Company secretary

Stuart Kelly – appointed 26 May 2017
Suzanne Wise – resigned 26 May 2017

Registered office

1 Eversholt Street
London
NW1 2DN

Independent auditors

National Audit Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Strategic report

The directors present their strategic report of Network Rail Infrastructure Limited (NRIL or the company) for the year ended 31 March 2018.

What we do

Network Rail owns and operates most of Britain's railway infrastructure, including 20,000 miles of track, 30,000 bridges and viaducts and thousands of signals, tunnels, level crossings and points. We also manage rail timetabling and operate 20 of the largest stations. Our role is to provide a safe, reliable and efficient railway while growing and upgrading the network to better serve passengers and freight.

How we are governed and managed

Network Rail is a public sector company, answerable to the Department for Transport (DfT) and Transport Scotland. Our direct customers are the companies that pay to use our infrastructure to provide passenger and freight services.

While the majority of our funding comes from Government, we are increasing our partnerships with third parties and generating funds from our commercial estate to reinvest in the railway.

The Office of Rail and Road (ORR) is the independent safety and economic regulator of the railway. The ORR makes sure we meet the needs of our customers, passengers and freight users, as well as being a good neighbour to the millions of people who live or work near the railway.

A diagram showing the governance framework we operate within can be found on page 54 of the Group's annual report and accounts.

Network Rail's Board of Directors provides the primary internal governance. For details of the directors, including their biographies, see pages 49 to 52 of the Group's annual report and accounts.

The executive committee, comprising the chief executive, the chief financial officer and other senior people, manages the day-to-day running of Network Rail. It meets on a regular basis to consider both strategic and operational matters and it is responsible for executing the objectives and strategy approved by the Board, providing leadership on safety, health and environmental matters, and establishing, monitoring and coordinating internal controls and risk management throughout the business.

Our Board is accountable to others in a number of ways:

- Financial – The ORR determines that we efficiently spend the income we receive and the outputs we must deliver during each five-year control period. Our chief executive is our accounting officer and is personally accountable to Parliament for Network Rail's stewardship of the public funds it receives.
- Regulatory – We are subject to the ORR's regulation for our health and safety performance and for management of the network consistent with our network licence.

The Board's corporate governance report starts on page 53 of the Group's annual report and accounts.

How we are organised and operate

We operate in a matrix structure, which means we work collaboratively across functions. This structure is made up of nine route businesses, central functions and route support services. Eight of the route businesses manage and run the rail network in a defined

Strategic report (continued)

geographical area and work closely with local train operating companies to deliver the best service possible for passengers. The ninth route operates nationally, working with freight and long distance operators.

As part of our matrix structure, our critical central functions support our nine route businesses; these are the System Operator, Technical Authority, Route Services, Infrastructure Projects and Digital Railway. In addition to these, there is a small corporate core that covers activities such as business strategy, functional policy, legal and corporate assurance, and communications. We also have Network Rail Property, which is a commercial division of Network Rail that manages our estate and property assets.

The matrix structure has been designed to make sure that our routes are supported by a national framework. This allows us to deliver in a fair and competitive way for our customers across the UK.

Our business model

We are a public sector company that operates as a regulated monopoly. Our income is a mix of grant and borrowing from the UK and Scottish Governments, charges levied on train operators that use our network, and income, mainly from our commercial property estate.

The UK and Scottish Governments specify what they want from Britain's railway and how much they wish to contribute. Our independent regulator, the ORR, sets a framework that specifies the level of fixed income we are allowed to charge train and freight operators, as well as the prices for recovering the costs of wear and tear to our infrastructure caused by the trains using it.

The framework also includes flexible funding mechanisms which allow the level of enhancements to the railway to be varied over time. The charges we are allowed to pass on to train operators are determined so that they are fair and allow us to maintain a safe and reliable network, and deliver good customer service.

How our revenue is determined

Network Rail is funded by the Government in five-year blocks called control periods. This annual report covers the fourth year of Control Period 5 (2014 to 2019).

The ORR assesses the efficient level of expenditure that it believes we need to run our business and deliver the regulated outputs. It determines how much revenue we need, taking into account other income that we receive. Our regulatory agreements then allow us to determine the amount we are allowed to charge train operators for use of our network.

The ORR calculates our revenue based on:

- **Cost of service** – The ORR considers the costs that an efficiently run business would incur to operate and maintain our network. They vary and can include costs relating to employees, office rental, information technology systems, and taxes. The regulator determines what it considers to be an efficient cost and this may be different to the actual costs we incur.
- **Expenditure on renewals and enhancements** – The regulator assesses the capital expenditure on renewals and enhancements to the rail network that we need to undertake in the control period. This expenditure is added to the regulatory asset base in the year in which it is incurred.

Strategic report (continued)

- Allowed return – The ORR calculates the allowed return on the regulatory asset base and includes this in its determination of charges to rail users. This therefore covers, among other things, the cost of financing our capital expenditure programme.
- Performance against incentives – Our regulatory framework includes incentives that are designed to encourage specific actions. Failing to achieve certain minimum targets may lead to a reduction in our allowed revenue, or an increase if we exceed targets.

It is proposed that there will be changes to the method of revenue determination for CP6. This will be explained in our 2019 annual report and further details on the proposals can be found in the ORR's draft determination published 12 June 2018.

Our transformation

Since we published 'Delivering for our Customers', our plan for transforming Network Rail, in 2016 there has been a fundamental change to the way we operate. Network Rail is now a federation of devolved businesses operating within a national framework. This year, each route developed its own Strategic Business Plan for the next control period (2019-2024) for the first time. The routes and the System Operator will have their plans and targets agreed with the ORR, which reinforces how important it is that we have devolved businesses making decisions at a local level. Routes will drive economic growth, jobs and housing through better relationships with the communities they serve.

Over the past 12 months we have continued to drive the pace of change within Network Rail. We want to make it easier for third parties to fund, finance or deliver work on the railways, so we are implementing a number of reforms that aim to cut red tape, so people can come forward with innovative solutions and new ways of working on the railway. This year we published a list of potential opportunities for third party involvement as part of our Open for Business work, and this is just the start of much more to come.

Becoming more cost efficient has also been a key part of our transformation and we are empowering our employees to become more cost-effective and taking a critical eye to current processes. We have already trained 5,500 of our people in continuous improvement techniques and in the last year we made approximately £85m of savings through our continuous improvement initiatives.

Real change takes time, but the progress we have made shows real improvements; working smarter, planning better and making more efficient use of the railway.

Our strategy

This year, Network Rail developed and submitted its Strategic Business Plan for the next five year control period (CP6) running from 2019 - 2024. As a passenger and customer-focused business, our plan for the next control period focuses on the following key responsibilities:

Safe

Keeping people safe on the railway is at the heart of everything Network Rail does. We want everyone home safe, every day. As well as it being a moral responsibility, we believe that improved safety and improved business performance go hand in hand. Safety will therefore continue to be our number one priority throughout the next control period, with a specific focus on four areas:

- Passenger Safety – We will reduce train accident risk by a further 10%.
- Public Safety – We will continue to develop programmes to reduce railway trespass and prevent suicides.

Strategic report (continued)

- Level Crossing Safety – We will reduce the risk to the public at level crossings by 13%.
- Workforce Safety – We want an injury-free and healthy business, so we will continue to improve our Lost Time Injury Frequency Rate (LTIFR) measure by 54%. We will also increase our work on mental health and resilience, with a target of a 30% reduction in absence due to mental ill-health by 2024.

Reliable

During the last 12 months we have begun to reverse the previous six year trend of declining train punctuality, but we are still not yet at a level that is acceptable. Our plan for the next five years, working with train operators, will achieve a 15% reduction in the number of trains that are delayed, focusing on:

- Better assets – Improving the reliability of the railway's infrastructure to reduce incidents that cause disruption.
- Better timetables – Improving the accuracy of assumptions on which the timetable is based.
- Better operations – Improving operational processes so that service recovery from incidents is rapid.
- Better information – Improving the accuracy of train running data to help problem solve.

Efficient

Driving greater efficiency within our organisation is also a core part of our strategy. During the last 10 years we have reduced the operating and maintenance cost of passenger journeys by 40%. Our plan for 2019 – 2024 proposes spending approximately £53bn (in 2017/18 prices) to operate, maintain, renew and enhance the railway, which we will spend wisely and efficiently. Between 2019 and 2024, we are forecasting that the cost per passenger kilometre of running the railway will reduce by a further nine per cent in real terms, through smarter working, more efficient use of the railway and better technology.

Growing

Moving into the next control period, we will continue to improve our railway through the delivery of enhancements. We have radically changed our approach to planning enhancements in recent years, to prevent projects from being overpromised before they are properly developed and costed.

From 2019, enhancements will be considered on a case by case basis rather than in one five year budget. This pipeline approach will be supported by business cases to confirm the strategic fit, value for money, affordability and deliverability of proposals.

Building new projects to increase capacity can be expensive and disruptive, particularly in built-up urban settings. So the next control period will mark a turning point for Britain's railway, with the end of major analogue re-signalling – digital signalling is the future that this plan ushers in. Over the next five years, we will be accelerating the transition to digitally-run railways so we can unlock the benefits before the network is gridlocked. Digital Railway is developing a plan that, within 10 years, could enhance the journeys of over 70% of all passengers.

Great People Great Teams

The delivery of this reforming, ambitious plan will only be possible if we can attract, develop and retain the brightest and the best. We want Network Rail to be a great place to work, and help to make people proud to work on Britain's railways.

Strategic report (continued)

We aim to be one of Britain's best employers. We aspire to create an environment that will allow everybody to reach their full potential. To reach our potential we must call on the talents of everyone; diverse teams perform better. We are leading the way in moving the rail industry to become more diverse and inclusive. We have set ourselves the target of

increasing the female workforce to 20% by 2020 and by 2024 we aim to double the proportion of women in our business. We also aim to be in the top 25 graduate employers and to have gender-balanced recruitment of apprentices and graduates.

Our approach to risk management

Our approach to risk management across Network Rail balances the risks associated with our operational environment and identifying opportunities to improve performance, through careful acceptance of some risk.

We recognise our status as a regulated rail network infrastructure provider and the importance of maintaining essential service provision.

The operational railway is continuously susceptible to changing environmental conditions. The success of the railways in the UK, measured by the growth in passenger numbers, and the continued drive for efficiency means that we must be both flexible and innovative in our risk mitigation strategies. Our enterprise approach to risk management provides multiple opportunities to review, monitor and enhance mitigations depending on the changing conditions and challenges.

Embedded risk management processes

We take an enterprise-wide approach to risk management and have an Enterprise Risk Management (ERM) framework in place for the identification, analysis, management and reporting of all risks to strategic objectives. The purpose of our ERM framework is to identify and mitigate risks to the delivery of a safe, reliable, efficient service to our customers. Our ERM framework supports all areas of the business to recognise both threats and opportunities early. Early recognition of risk allows us to work collaboratively and proactively with customers, stakeholders and suppliers to manage our extensive portfolio of works better. Being better every day requires us to look at areas where we can improve our service. By careful consideration of risk we can focus on those opportunities that have the highest potential to increase efficiency and provide a better experience for our customers.

The risk processes within our ERM framework provide tailored approaches for specialist areas such as safety, project management and information security. The use of a standard risk assessment matrix and defined risk appetite enables integration of operational and strategic risks. Line of sight and links between risks are documented and visualised through our award winning risk visualisation approach. Strategic risks are linked to our corporate scorecard and business plans are required to document and assess risks to delivery against the corporate risk appetite statements.

Clear escalation criteria and the use of business assurance committees throughout the business provide structured governance, challenge and assurance. We have introduced the concept of risk trajectory to enable more informed challenge on the effectiveness of risk mitigations. The establishment of early warning indicators (EWIs) provides the ability to continuously monitor how effective our controls are at managing the root causes of our principal risks. By using current reporting and monitoring techniques, such as visualisation boards and periodic reviews, we can better link risk with performance.

Whilst the ultimate responsibility for risk management rests with the Board, it delegates the more detailed oversight of risk management and internal control principally to the audit and

Strategic report (continued)

risk committee, which reports the findings of its reviews to the Board. The audit and risk committee receives regular reports from the internal and independent auditors and reviews progress against agreed action plans to manage identified risks. Detailed oversight of safety related risks is delegated to the safety, health and environment committee.

Categories of risks (i.e., safety, performance, value) and who manages them

All principal risks are mapped to performance reporting and strategic objectives. The assessment of risk is informed by the performance targets and the company's risk appetite statements. Each risk is appointed an executive committee owner.

Network Rail has defined its risk appetite as follows:

Network Rail has no appetite for safety, health or environmental risk exposure that could result in injury or loss of life to public, passengers and workforce or irreversible environmental damage. Safety drives all major decisions in the organisation. Network Rail will consider options to reduce safety risk where the business case goes substantially beyond our legal obligation to reduce risk so far as is reasonably practicable.

In the pursuit of its objectives, Network Rail is willing to accept, in some circumstances, risks that may result in some financial loss or exposure including a small chance of breach of the loan limit. It will not pursue additional income generating or cost saving initiatives unless returns are probable (85% CI for income and 60% CI for cost reductions where potential returns are high).

The company will only tolerate low to moderate gross exposure to delivery of operational performance targets including network reliability and capacity and asset condition, disaster recovery and succession planning, breakdown in information systems or information integrity.

The company wants to be seen as best in class and respected across industry. It will only tolerate low to moderate exposure that may result in short term negative impact on reputation and stakeholder relationships and is easily recoverable, i.e. minimal negative local or industry media coverage, and/or minor employee experience and political impact. This will continue to be balanced by regular positive media coverage at national and local level.

Approved by the board of directors and signed on behalf of the board



Mark Carne (director)
27 June 2018

Directors' report

The directors present their audited financial statements of the company for the year ended 31 March 2018.

Business review

For the year ended 31 March 2018 the company made a pre-tax profit of £219m (2017: £361m pre-tax profit). The tax credit for the year was £30m (2017: credit of £69m).

Details on the company's performance and indicators are detailed in the annual report of Network Rail Infrastructure Limited's ultimate parent company; Network Rail Limited.

Future activities

The directors do not envisage any changes in the company's principal activities in the foreseeable future.

Dividends

No dividends were paid in the current year (2017: £nil).

Disabled employees

The company is committed to employment policies, which follow best practice, based on equal opportunities for all employees, irrespective of sex, race, colour, disability or marital status. The company gives full and fair consideration to applications for employment for disabled persons, having regard to their particular aptitudes and abilities. Appropriate arrangements are made for the continued employment and training, career development and promotion of disabled persons employed by the company. If members of staff become disabled the company continues employment, either in the same or an alternative position, with appropriate retraining being given if necessary.

Political donations

There were no political donations made in the current or prior years.

Directors

The directors of the company who were in office during the year and up to the date of signing the financial statements are listed on page 1.

Statement of directors' responsibilities

The directors are responsible for preparing the strategic report, directors' report and the financial statements in accordance with applicable law and regulations.

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

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements;

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial

Directors' report (continued)

statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

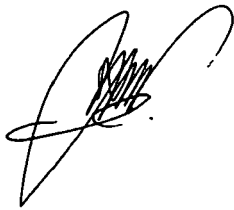
The directors consider that the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for its member to assess the company's performance, business model and strategy.

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

Each director of the company, in office at the time of approval of this report, acknowledges that:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- he/ she has taken all the steps that he/ she ought to have taken as a director in order to make himself/ herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Approved by the board of directors and signed by order of the board

A handwritten signature in black ink, appearing to be 'J Westlake', written over a horizontal line.

Jeremy Westlake
Chief Finance Officer
27 June 2018

Independent auditors' report

to the Members of Network Rail Infrastructure Limited

Opinion on financial statements

I have audited the financial statements of Network Rail Infrastructure Limited for the year ended 31 March 2018 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Cash Flows and the related notes, including the significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and the International Financial Reporting Standards as adopted by the European Union.

In my opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2018 and of the profit for the year then ended; and
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by European Union; and
- have been prepared in accordance with the Companies Act 2006.

Opinion on regularity

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

Basis of opinions

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

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities, the directors are responsible for:

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

Auditor's responsibilities for the audit of the financial statements

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

Independent auditors' report (continued)

to the Members of Network Rail Infrastructure Limited

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

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

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Network Rail Infrastructure Limited's internal control.
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Network Rail Infrastructure Limited's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the entity to cease to continue as a going concern.
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

Independent auditors' report (continued)

to the Members of Network Rail Infrastructure Limited

Other Information

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

Opinion on other matters prescribed by the Companies Act 2006

In my opinion:

- in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, I have not identified any material misstatements in the Strategic Report or the Directors' Report; and
- the information given in the Strategic and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and those reports have been prepared in accordance with applicable legal requirements.

Matters on which I report by exception

I have nothing to report in respect of the following matters where the Companies Act 2006 requires me to report to you if, in my opinion:

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



Matthew Kay (Senior Statutory Auditor)

28 June 2018

For and on behalf of the

Comptroller and Auditor General (Statutory Auditor)

National Audit Office

157-197 Buckingham Palace Road

Income statement

for the year ended 31 March 2018

	Note	2018 £m	2017 £m
Revenue	3	6,587	6,252
Net operating costs	4	(4,804)	(4,380)
Operating profit	5	1,783	1,872
Property revaluation movements and profits on disposal		269	248
Profit from operations		2,052	2,120
Finance income	8	9	4
Other gains and losses	9	236	(145)
Finance costs	10	(2,078)	(1,618)
Profit before tax		219	361
Tax	11	30	69
Profit for the year attributable to the owner of the company		249	430

Statement of comprehensive income

for the year ended 31 March 2018

	Notes	2018 £m	2017 £m
Profit for the year		249	430
Other comprehensive (expense)/income:			
Items that will not be reclassified to profit or loss			
Gain/(loss) on revaluation of the railway network	12	675	(1,075)
Actuarial gain/(loss) on defined benefit pension schemes	27	221	(800)
Tax relating to components of other comprehensive income	22	(153)	351
Reclassification of balances in the hedging reserve to the income statement		5	6
Other comprehensive income/(expense) for the year		748	(1,518)
Total comprehensive income/(expense) for the year		997	(1,088)

Statement of changes in equity

for the year ended 31 March 2018

	Share capital £m	Share premium £m	Revaluation reserve £m	Other reserves* £m	Hedging reserve £m	Retained earnings £m	Total £m
Balance at 31 March 2017	160	85	832	1,458	(42)	3,076	5,569
Profit for the year						249	249
Other comprehensive income							
Revaluation of the railway network	-	-	675				675
Transfer of deemed cost depreciation from revaluation reserve	-	-	3	-	-	(3)	-
Decrease in deferred tax liability on the railway network	-	-	(117)	-	-	1	(116)
Actuarial loss on defined benefit pension schemes	-	-	-	-	-	221	221
Deferred tax on actuarial loss	-	-	-	-	-	(37)	(37)
Reclassification of balances in hedging reserve to the income statement	-	-	-	-	5	-	5
Total comprehensive income for the year:	-	-	561	-	5	182	748
Balance at 31 March 2018	160	85	1,393	1,458	(37)	3,507	6,566

Statement of changes in equity (continued)

for the year ended 31 March 2017

	Share capital £m	Share premium £m	Revaluation reserve £m	Other reserves* £m	Hedging reserve £m	Retained earnings £m	Total £m
Balance at 31 March 2016	160	85	1,349	1,458	(48)	3,653	6,657
Profit for the year	-	-	-	-	-	430	430
Other comprehensive income							
Impact of rate change	-	-	15	-	(1)	15	29
Revaluation of the railway network	-	-	(1,075)	-	-	-	(1,075)
Transfer of deemed cost depreciation from revaluation reserve	-	-	(6)	-	-	6	-
Decrease in deferred tax liability on the railway network	-	-	205	-	-	(1)	204
Actuarial loss on defined benefit pension schemes	-	-	-	-	-	(800)	(800)
Deferred tax on actuarial loss	-	-	-	-	-	117	117
Reclassification of balances between reserves	-	-	344	-	-	(344)	-
Deferred tax on all hedging reserve movements/ retained earnings	-	-	-	-	1	-	1
Reclassification of balances in hedging reserve to the income statement	-	-	-	-	6	-	6
Total comprehensive (expense)/income for the year:	-	-	(517)	-	6	(577)	(1,088)
Balance at 31 March 2017	160	85	832	1,458	(42)	3,076	5,569

* Other reserves of £X (2017: £1,458m) include the vesting reserve on privatisation.

Balance sheet

at 31 March 2018

		2018 £m	2017 (restated) £m
Assets			
Non-current assets			
Property, plant and equipment – the railway network*	12	64,117	59,181
Investment property	13	206	1,231
Investment in subsidiaries	16	320	359
Other receivables	17	-	37
Interest in joint ventures	28	3	13
Loans to subsidiaries	28	56	39
		64,702	60,860
Current assets			
Assets held for sale	15	1,134	-
Inventories	14	211	188
Trade and other receivables	17	931	996
Current tax assets		4	7
Derivative financial instruments	20	-	2
Cash and cash equivalents		739	609
		3,019	1,802
Total assets		67,721	62,662
Liabilities			
Current liabilities			
Trade and other payables	18	(2,515)	(3,740)
Borrowings	19	(4,652)	(3,202)
Derivative financial instruments	20	(1,051)	(1,288)
Provisions	21	(83)	(67)
		(8,301)	(8,297)
Net current liabilities		(5,282)	(6,495)
Non-current liabilities			
Borrowings	19	(47,743)	(43,625)
Derivative financial instruments	20	-	(2)
Other payables*	18	(281)	(463)
Retirement benefit obligation	27	(2,311)	(2,311)
Deferred tax liabilities	22	(2,519)	(2,395)
		(52,854)	(48,796)
Total liabilities		(61,155)	(57,093)
Net assets		6,566	5,569
Equity			
Share capital	23	160	160
Share premium account		85	85
Revaluation reserve		1,393	832
Other reserve		1,458	1,458
Hedging reserve		(37)	(42)
Retained earnings		3,507	3,076
Total equity		6,566	5,569

* Prior year comparatives have been restated for these balances. See change in accounting treatment policies on page 18 for more details.

The financial statements on pages 12 to 71 were approved by the board of directors and authorised for issue on 27 June 2018. They were signed on its behalf by:



Mark Carne, Director



Jeremy Westlake, Director

Company number:
2904587

Statement of cash flows

for the year ended 31 March 2018

	Note	2018 £m	2017 £m
Cash flow from operating activities			
Cash generated from operations	24	3,541	3,550
Interest paid		(1,489)	(1,412)
Income tax received		4	1
Net cash flows generated from operating activities		2,056	2,139
Investing activities			
Interest received		9	4
Purchases of property, plant and equipment		(6,547)	(6,837)
Proceeds on disposal of property		159	101
Capital grants received		806	356
Investment in joint ventures		49	-
Loan to subsidiaries		(17)	8
Other capital expenditure		(1,268)	-
Net cash used in investing activities		(6,809)	(6,373)
Financing activities			
Movement in intercompany borrowings		(1,839)	(2,010)
Movement in DfT borrowings		6,713	6,097
Repayment of bank loans		-	-
Increase in bank overdraft		9	(41)
Cash flow on settlement of derivatives		-	(7)
Net cash generated from financing activities		4,883	4,039
Net movement in cash and cash equivalents		130	(195)
Cash and cash equivalents at beginning of the year		609	804
Cash and cash equivalents at end of the year		739	609

Notes to the financial statements

for the year ended 31 March 2018

1. General information

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

The company registration number is 2904587. The company's registered office is situated at 1 Eversholt Street, London, NW1 2DN, United Kingdom.

The company's principal activities are detailed in the strategic report on pages 2 to 7.

The company's parent is Network Rail Holdco Limited, a private company incorporated in Great Britain and registered in England and Wales. The company's ultimate parent company is Network Rail Limited, a company limited by guarantee incorporated in Great Britain and registered in England and Wales.

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

2. Accounting policies

Basis of preparation

The company is a wholly-owned subsidiary of Network Rail Limited, its ultimate parent, company, and is included in the consolidated financial statements of Network Rail Limited which are publicly available. Consequently, the company has taken advantage of the exemption from preparing consolidated financial statements under the terms of section 400 of the Companies Act 2006.

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

The financial statements have been prepared under the historical cost basis, except for the revaluation of the railway network to a value determined using an income approach, the revaluation of investment properties, the measurement of certain financial assets and liabilities at fair value through profit and loss (FVTPL), and the measurement of derivative financial instruments at fair value. The principal accounting policies adopted by the directors are set out below. The policies have been consistently applied to the years presented.

Change in presentation of government grants

Government grants have previously been recognised as a deferred income within non-current other payables. During the financial year Network Rail adopted the alternative method of presenting government grants by deducting grants in arriving at the carrying value of plant, property and equipment, as permitted by IAS20. Due to changes in Network Rail's funding arrangements management deemed the alternative method of netting off capital grants with the cost of associated property, plant and equipment as a more reliable and transparent method going forward. In preparing the consolidated financial statements, comparative amounts have been restated for the adoption of the revised accounting treatment.

The financial impact of the change in presentation is set out in note 12 and note 18.

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

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

Adoption of new and revised standards

The accounting policies adopted in this set of financial statements are consistent with those set out in the annual financial statements for the year to 31 March 2017; except for the change in accounting policy noted above.

The following accounting standards have not been early adopted by the company but will become effective in future years and are considered to have a potentially material impact on the company:

- i) IFRS16 'Leases' establishes principles for the recognition, measurement, presentation and disclosure of leases, with the objective of ensuring that lessees and lessors provide relevant information that faithfully represents those transactions. The standard is effective for accounting periods starting after 1 January 2019 and will be effective in Network Rail's 2019-2020 annual accounts. The standard will require lessees to account for all leases on their balance sheets, including those which had previously been treated as operating leases and accounted for in the Income Statement as an "in-year" expense. Had this standard been adopted in 2017-18 Network Rail's assets and liabilities would have been less than £200m higher and profit for the year less than £10m lower.

The following accounting standards have not been early adopted by the company but will become effective in future years and are considered to have a potentially material impact on the company but have not yet been assessed by the company:

- i) IFRS 17 'Insurance Contracts' This is a new standard released in May 2017 and applicable to annual periods from 1 January 2021.

The following accounting standards have not been early adopted by the company but will become effective in future years and are not considered to have a material impact on the company:

- i) IFRS 9 'Financial Instruments'. This is a new standard that addresses the classification, measurement and recognition of financial assets and liabilities. It is effective for accounting periods starting after 1 January 2018 and will be effective in Network Rail's 2018-2019 annual accounts. Network Rail has assessed the impact on financial assets and with the exception of derivatives held at fair value, they will continue to be held at amortised cost as they are held-to-collect rather than traded assets.

With regard to hedge accounting almost all the hedged events have now occurred and there will be no new hedging programme. It is therefore proposed to continue using the IAS 39 model for the final periods of hedge accounting.

As financial assets, the receivables disclosed in Network Rail accounts will be subject to the new "Expected Credit Loss" model. Network Rail's exposure to credit risk is limited largely to the property rental income and that had the new standard been adopted in 2017-18 then Network Rail estimates that profit would be less than £1m lower than currently reported. See trade and other receivables note on page 44 for more details.

- ii) IFRS 15 'Revenue from Contracts with Customers' establishes a comprehensive framework for determining when revenue should be recognised and how it should be measured. It is effective for accounting periods starting after 1 January 2018 and will be effective in Network Rail's 2018-2019 annual accounts. The grant income that Network Rail receives does not fall under IFRS 15; as such we will continue to recognise grant income in line with IAS 20 Accounting for Government Grants. Revenue from train operators has been assessed using the five-step model prescribed by the IFRS 15 and deemed that Network Rail's revenue recognition will be as it is under existing accounting

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

standard. Network Rail believes its current accounting approach to revenue is materially in line with IFRS15 and any minor adjustment required will result in a less than £5m change in reported profit.

There are no other IFRS or IFRS Interpretation Committee interpretations not yet effective that would be expected to have a material impact on the company.

Business segments

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

Going concern

The company has considerable financial resources together with long-term contracts with a number of customers and suppliers. This includes the DfT loan facility of £30.875bn, which alongside the disposal of certain property assets, Network Rail will draw upon to deliver its investment activities in the next 12 months. In addition Network Rail is able to achieve further efficiencies and deferral of costs as required to live within the funding available. Business plans and financial models are used to project cash flows and monitor financial risks and liquidity positions, forecast future funding requirements and other key financial ratios, including those relevant to our network licence. Analysis is undertaken to understand the resilience of the company and its business model to the potential impact of the company's principal risks, or a combination of those risks. This analysis takes account of the availability and effectiveness of the mitigating actions that could realistically be taken to avoid or reduce the impact or occurrence of the underlying risks. In considering the likely effectiveness of such actions, the conclusions of the board's regular monitoring and review of risk management and internal control systems.

In addition, Note 26 to the financial statements includes the company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit, liquidity and foreign exchange risk.

After making enquiries, the directors have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Revenue recognition

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

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

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

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

Grants

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

Leasing

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

The company as lessor

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

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

The company as lessee

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

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

Foreign currencies

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

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

Borrowing costs

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

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

Operating profit

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

For the year ended 31 March 2018, the income statement has been simplified by removing the three column format as it was felt that the previous format was causing an unnecessary level of complexity.

Retirement benefit costs

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

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

The company's share of the actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the income statement and presented in the statement of comprehensive income. Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the plan. Further details on the retirement benefit schemes are provided in note 27.

The company reflects its share of the obligation in the financial statements. The IAS 19 deficit, service cost and interest cost therefore represent 60 per cent of the total for each of the schemes. Further details on the retirement benefit schemes are provided in note 27.

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

Tax

The tax expense represents the sum of the current tax payable and deferred tax. The company's current tax liability is calculated using the tax rates that have been enacted or substantively enacted by the balance sheet date. Current taxes are based on the taxable results of the company and calculated in accordance with tax rules in the United Kingdom.

Deferred tax is the tax expected to be payable or recoverable on the temporary differences that arise when tax authorities recognise and measure assets and liabilities with rules that differ from those of the consolidated financial statements. Deferred taxes are calculated under the balance sheet liability method at the rate of tax expected to prevail, subject to the rate being enacted or substantively enacted by that date, when the temporary differences reverse.

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

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

Investment in subsidiaries and joint ventures

Investments in subsidiary undertakings and joint ventures are stated at cost plus incidental expenses less any provisions for impairment. Where an event has occurred that gives rise to doubt about the recovery of the carrying value an impairment assessment review is performed by management.

Assets held for sale

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

Immediately before classification as held for sale the assets are re-measured in accordance with the accounting policies for the asset category. Subsequently, the assets are held at the lower of carrying value and fair value less costs to sell. Any impairment loss on a disposal group is recognised immediately in the income statement. For the assets held for sale in these financial statements Network Rail has opted to use the valuation as at 30 September 2017 as a proxy for the value of the assets immediately before classification date.

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

Property, plant and equipment – the railway network

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

Valuation methodology

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

Depreciation

The railway network is depreciated on a straight-line basis over its estimated remaining weighted average useful economic life. The estimated remaining weighted average useful economic life of the network is currently 40 years (2017: 40 years). The remaining useful economic lives of network assets are estimated annually, with external verification of the valuation and asset lives carried out where required.

Capitalisation of operating costs

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

Investment property

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

Research and development

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

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

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

Inventories

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

Financial instruments

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

Financial assets

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

Financial assets at FVTPL

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

A financial asset is classified as held for trading if:

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

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

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

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

Financial liabilities

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

Financial liabilities at FVTPL

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

A financial liability other than a financial liability held for trading is designated as at FVTPL upon initial recognition if such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise exist, in line with International Accounting Standard 39 Financial Instruments: Recognition and Measurement, paragraph 9.

The company derecognises financial liabilities when, and only when, the company's obligations are discharged, cancelled or have expired.

Debt

Debt instruments not designated at FVTPL are initially measured at fair value, net of discount and direct issue costs, and subsequently recognised at amortised cost using straight line amortisation as a proxy for the IAS 39 effective interest rate method. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accrual basis to the income statement using the effective interest rate method, and are added to the carrying value of the debt instrument to the extent that they are not settled in the period in which they arise.

Trade payables

Trade payables are initially recognised at fair value and subsequently at amortised cost. They are ordinarily not interest bearing.

Derivative financial instruments and hedge accounting

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

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

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

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

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

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

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

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

Cash flow hedges

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

Provisions

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

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

Critical accounting judgements and key sources of uncertainty

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

The most significant judgement underpinning the valuation is that the regulatory framework and associated cash flows remain sufficiently stable and robust to form the basis of a third party valuation. Management assess that based on the current regulatory environment, an investor could reasonably expect to recover the RAB value through the revenue deriving from future amortisation allowances and the regulatory return thereon. In its assessment management has considered the amendments to the regulatory framework that are set out in the regulator's draft determination for Control Period 6 (2019-2024), and noted that although the regulated asset base will cease to be a building block in the determination of the company's revenue requirement, the link between income and the regulated asset base would be reinstated in the event that the rail network asset were transferred to a private owner.

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

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

Whilst not affecting the fair value of the asset recognised at the balance sheet date, management's assessment of the remaining life of the asset affects the depreciation that is charged on the asset, and is also an area of estimation uncertainty. IAS 16 requires that management regularly review asset lives on at least an annual basis and that that depreciation is charged on a systematic basis that reflects the way the asset is consumed. In September 2016 Network Rail produced a detailed and rigorous depreciated replacement cost (DRC) valuation of the rail network for inclusion in DfT's group accounts. In preparing these financial statements management reviewed the weighted average remaining asset lives as produced in the DRC valuation and concluded that it is still appropriate to use 40 years as the weighted average remaining life.

(ii) Investment property – an element of the investment property portfolio valuation is determined using the Beacon method. Jones Lang LaSalle provided their assessment of yields for 13 properties in the portfolio. These are then used to produce income multipliers and applied to the rental streams from each of the individual properties in the portfolio to form an overall valuation. For investment property transferred to assets held for sale this is also the inherited method of valuation. The transfer occurred on 24 November 2017; the valuation as at this date is regarded as the carrying value of these assets and the frozen ceiling valuation for assets held for sale. Further details are set out in Note 13.

Notes to the financial statements

for the year ended 31 March 2018

2. Accounting policies (continued)

(iii) Retirement benefit obligations – the company recognises and discloses its retirement benefit obligation in accordance with the measurement and presentational requirement of IAS 19 (Revised) Employee Benefits. The calculations include a number of judgements and estimations in respect of the expected rate of return on assets, the discount rate, inflation assumptions, the rate of increase in salaries and life expectancy among others. Changes in these assumptions can have a significant effect on the value of the retirement benefit obligation. The key assumptions made are set out in Note 27. The total contribution rate payable under the Railway Pension Scheme (RPS) and the Career Average Revalued Earnings (CARE) scheme is normally split in the proportion 60:40 between the company and the members, respectively. The company reflects its share of the contribution in the financial statements.

(iv) Taxation – the company recognises and discloses its deferred tax assets in accordance with IAS 12. Where it is considered to be probable that deferred tax assets can be matched to future taxable profits then deferred tax assets are recognised, or offset against the overall deferred tax provision as appropriate. This evaluation requires significant judgements to be made, including the uncertainty of the availability of future taxable profits. Further details are set out in Note 11.

3. Revenue

	31 March 2018 £m	31 March 2017 £m
Grant income	4,480	4,380
Franchised network access	1,715	1,499
Freight revenue	53	53
Property rental income	305	292
Other income	34	28
Revenue for the year	6,587	6,252

The effect of the performance regimes was a net loss of £232m (2017: net loss of £180m) which led to reduction in revenue of the respective amount.

Property rental income relating to assets held for sale on the balance sheet was £81m.

Notes to the financial statements

for the year ended 31 March 2018

4. Net operating costs

	31 March 2018 £m	31 March 2017 £m
Employee costs (see note 6)	2,418	2,159
Own costs capitalised	(976)	(985)
Other external charges (including maintenance costs)	2,049	1,990
Other operating income and recoveries	(234)	(218)
Net operating costs before depreciation and amortisation	3,257	2,946
Depreciation (see note 12)	1,639	1,515
Capital grants amortised	(92)	(81)
Net operating costs	4,804	4,380

Other external charges relating to assets held for sale on the balance sheet was £17m.

5. Profit from operations

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

	31 March 2018 £m	31 March 2017 £m
Profit on sale of properties	(78)	(74)
Increase in the fair value of investment properties	(116)	(131)
Cost of inventories recognised as an expense	190	215
Dividends from investments	(75)	(43)
Write down of inventories recognised as an expense	1	(2)
Amounts payable to auditors		
Fees payable to the company's auditors for the audit of the company's financial statements	0.02	0.02
Fees payable to the company's auditors for other audit related services:		
- The audit of the company's subsidiaries and consolidated financial statements of the parent company	0.41	0.38
- Regulatory accounts audit and interim review	0.08	0.08
Total amounts payable to auditors	0.51	0.48

In the financial years ended 31 March 2018 and 2017 there were no fees payable to the company's auditors in respect of non-audit related services. In addition to the audit fee information given in the table the company pays £0.11m for the audit of subsidiaries that are not performed by the group auditor. The company bears the cost of the statutory audit fees for the entire Network Rail group of companies.

Notes to the financial statements

for the year ended 31 March 2018

6. Employee costs

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

	31 March 2018	31 March 2017
Management and operation of the railway	39,370	38,530

	31 March 2018 £m	31 March 2017 £m
Their aggregate remuneration comprised:		
Wages and salaries	1,928	1,802
Social security costs	215	203
Defined contribution pension costs (see note 27)	19	18
Defined benefit pension costs – current service costs (see note 27)	256	136
Defined benefit pension costs – past service costs (see note 27)	-	
	2,418	2,159

7. Directors' remuneration

	31 March 2018 £m	31 March 2017 £m
Total emoluments	2	2
Post employment benefits - contributions to money purchase pension schemes	0	0
	2	2

During the year ended 31 March 2018, the key management personnel were comprised of the chair of the non-executive committee and two executive directors.

The aggregate short-term employee benefits payable to these directors totalled £1.5m (2017: £1.7m) and aggregate post-employment benefits payable totalled £0.1m (2017: £0.1m). No other benefits were paid to these individuals. For further details see the directors' remuneration report in the Network Rail Limited group accounts.

Notes to the financial statements

for the year ended 31 March 2018

8. Finance income

	Year ended 31 March 2018 £m	Year ended 31 March 2017 £m
Interest receivable on Finances and deposits (included in borrowings)	9	4
	9	4
Finance income earned on financial assets analysed by category of asset is as follows:		
Loans and receivables (including cash and bank balances)	9	4
	9	4

9. Other gains and losses

	Year ended 31 March 2018 £m	Year ended 31 March 2017 £m
Loss on fair value of embedded derivative	236	(139)
Gain on fair value of external derivative financial instruments	-	(6)
Total other losses	236	(145)

No other gains and losses have been recognised in respect of loans and receivables other than those disclosed in this note. No gains or losses have been recognised on financial liabilities measured at amortised cost other than those disclosed in Note 10.

Notes to the financial statements

for the year ended 31 March 2018

10. Finance costs

	Year ended 31 March 2018 £m	Year ended 31 March 2017 £m
Interest on bank loans and overdrafts	-	5
Finance cost on loan issued by Department of Transport	546	417
Finance cost on intercompany borrowings	1,368	1,005
Defined benefit pension interest cost (see note 27)	57	45
Debt Issuance Programme financial indemnity fee	281	300
Other interest	-	-
Total borrowing costs	2,252	1,772
Less: capitalised interest	(174)	(154)
Total finance costs	2,078	1,618

Borrowing costs are included in the costs of qualifying assets to the extent that the asset is financed by the company. The average rate used during the year was 4.5 per cent (2017: 4.4 per cent).

Notes to the financial statements

for the year ended 31 March 2018

11. Tax

The tax credit is made up as follows:

	Year ended 31 March 2018	Year ended 31 March 2017
Current tax:		
Corporation tax charge	(3)	(2)
Less advance corporation tax set-off	-	-
Corporation tax liability	(3)	(2)
Adjustment in respect of prior years	1	5
Total current tax charge/(credit)	(2)	3
Deferred tax:		
Current year charge	(6)	94
Effect of rate change	-	(91)
Adjustment in respect of prior years	(22)	(75)
Total deferred tax credit	(28)	(72)
Total credit	(30)	(69)

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

	Year ended 31 March 2018 £m	Year ended 31 March 2017 £m
Profit before tax	219	361
Tax charge on profit 19 per cent (2017: 20 per cent)	42	72
Adjustment in respect of prior years	(20)	(70)
Effect of rate change	-	(91)
(Income)/Expenditure not subject to tax	(29)	43
De-recognition of deferred tax assets – current year	-	1
Utilisation of tax losses previously written off	(23)	(24)
Total tax credit for the year	(30)	(69)

Notes to the financial statements

for the year ended 31 March 2018

11. Tax (continued)

Under IAS12 deferred tax assets can only be recognised where it is probable that taxable profits will be available against which the deferred tax asset can be utilised. As in 2017, it remains improbable that Network Rail will return to a level of taxable profits that will allow for recognition of deferred tax asset relating to the trading losses carried forward. Additionally, whilst taxable income does not exceed allowable deductions in the year, Network Rail claims only the capital allowances sufficient to make the necessary claims for group relief and available tax credits.

Deferred tax at 31 March 2018 is calculated at a rate of 17 per cent (2017: 17 per cent).

UK corporation tax is calculated at 19 per cent (2017: 20 per cent). Further reductions to the UK tax rate have been enacted which reduced the rate to 19% with effect from 1 April 2017 and to 17% by 1 April 2020.

The company has £36.9m (2017: £37.0m) of surplus ACT carried forward. No deferred tax asset has been provided in respect of this amount.

Notes to the financial statements

for the year ended 31 March 2018

12. Property, plant and equipment – the railway network

	Assets £m	Capital grants £m	Carrying Value £m
Valuation			
At 31 March 2016	58,508	(3,168)	55,340
Additions	6,788	(437)	6,351
Depreciation charge for the year	(1,515)	80	(1,435)
Revaluation in the year	(1,075)	-	(1,075)
At 31 March 2017	62,706	(3,525)	59,181
Additions	6,634	(822)	5,812
Transfers from investment property	3	-	3
Depreciation charge for the year	(1,639)	91	(1,548)
Revaluation in the year	675	-	675
At 31 March 2018	68,373	(4,256)	64,117

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

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

To date, the independent rail regulator, the Office of Rail and Road (ORR), has determined the revenue requirement of the network licence holder using the building block model of regulation. Under this model the network licence holder's annual income (received in the form of the network grant and track access charges) has comprised:

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

In its draft determination for Control Period 6 (2019-2024), published on 12 June 2018, ORR explains that from 1 April 2019 the RAB will no longer be a building block in the determination of the company's revenue requirement, but that the previous method of revenue determination would be restored if the rail network asset were to be transferred to a private owner. IFRS 13 Fair Value Measurement requires management to assess fair value from the perspective of a theoretical market participant, rather than on the basis of the value in-use. Accordingly, the amendments made to the regulatory framework for

Notes to the financial statements

for the year ended 31 March 2018

12. Property, plant and equipment – the railway network (continued)

Control Period 6, which reflect the proximity of Network Rail to the public sector and which would not apply to a market participant, are not relevant to the valuation.

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

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

- a) Adjustment for any difference between regulatory rate of return and the market cost of capital that a third party investor would use to assess the value of the network; and
- b) Adjustment for forecast future under or out performance against the regulatory determination.

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

Third party funding

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

Depreciation

The depreciation charge for any year is calculated using the average carrying value for the year and the estimated remaining weighted average useful economic life of the railway network. The remaining weighted average useful economic life of the railway network was calculated using the engineering assessment of serviceable economic lives of the major categories that comprise the railway network. The estimated remaining weighted average useful economic life of the network is currently 40 years (2017: 40 years).

Discount rate

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

Notes to the financial statements

for the year ended 31 March 2018

12. Property, plant and equipment – the railway network (continued)

The ORR determined that for CP5 it would not provide Network Rail with a full market cost of capital. The ORR believed that because Network Rail is primarily funded by debt supported by the Financial Indemnity Mechanism it is not necessary to provide a return on equity. A change in the rate of return affects the allowed return element of Network Rail's income, but the RAB is not affected. The ORR confirmed that a conventionally funded market participant would receive an allowed return equal to the full market cost of capital. This has been reiterated in their final determination for CP6.

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

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

The valuation includes a reassessment of this rate to determine whether it continues to reflect conditions in the market in between review dates. This assessment is by reference to movements in observable market data, including the risk-free cost of borrowing, and changes in the weighted average cost of capital of listed utilities with similar gearing ratios.

The following table shows the effect of changes in the market discount rate on the carrying value of the railway network and on the depreciation charge. The analysis only considers the effects of movements in the market discount rate until the end of the control period (2019), and not in perpetuity. This is because the regulator performs a review every five years, so the rate applicable to the income streams derived from the railway network will be rebased to the market every five years. The effects of changes in the market discount rate apply equally to increases and to decreases in discount rates.

	Change in cost of capital (basis points)	31 March 2018	31 March 2017
Change in fair value	25 basis points	£173m	£318m
	50 basis points	£346m	£635m
% change in fair value	25 basis points	0.3%	0.5%
	50 basis points	0.5%	1.0%
Change in annual depreciation charge	25 basis points	£6m	£11m
	50 basis points	£12m	£21m

Forecast performance variations

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

Notes to the financial statements

for the year ended 31 March 2018

12. Property, plant and equipment – the railway network (continued)

Cost outturns on capital work (renewals and enhancements) have an impact on future cash flows under the regulatory framework, since only a fraction of spend in excess of regulated cost targets can be added to the RAB. (There is also a similar incentive for out-performance.) Enhancement performance is measured against the Hendy baseline of cost re-forecasts which followed the 2016 Hendy review into CP5 projects. This is the benchmark that a third party would use in assessing the valuation of the rail network.

At 31 March 2018 the valuation included £1,326m (2017: £1,308m) of projected financial underperformance, which is expected to crystallise in the income statement or result in the ineligibility of additions to the RAB primarily in 2018-19.

The most significant areas of projected underperformance are renewals (£243m), operating expenditure (£645m), income (£464m) and enhancements (£37m) offset by out-performance on financing costs (£63m) as a result of favourable interest rate movements, after allowing for the impact of inflation increases on RPI-linked bonds.

The areas of performance subject to greatest estimation uncertainty are renewals and enhancements due to the complexities of forecasting cost and volume outcomes, and the Anticipated Final Cost of projects respectively.

The company estimates that a one per cent increase in the Anticipated Final Cost of enhancement projects would result in additional financial underperformance of £10m, and a one per cent increase in the unit cost of renewals would result in additional financial underperformance of £8m.

Critical judgements

The valuation includes the following critical judgements:

- a) The regulatory framework, and associated cash flows remain sufficiently stable and robust to form the basis of a third party valuation. As noted above, the ORR has made it clear in its final determination for Control Period 6 that the amendments made to the regulatory framework for CP6 reflect the proximity of Network Rail to the public sector and the amendments would not apply to a market participant.
- b) The ORR has committed to providing a market cost of capital return to a conventionally funded owner and operator of the network and the fair value calculation has been prepared on that basis.
- c) Management's assessment of the deliverability of the current regulatory determination is a good indication of how other management groups would perform against the determination.
- d) The deliverability of the current 5-year regulatory determination does not have any implication for the deliverability of future determinations (i.e. the ambition of the regulator at the start of each Control Period is to set the regulatory determination at a level which is challenging but achievable).
- e) The regulator would most probably take action to prevent a market participant from achieving an equity gain through selling the assets classified as held for sale at 31 March 2018. This assumption is based on the draft proposal of the final determination for Control Period 6 for non-core asset sales to create the presumption of a reduction of the Regulated Asset Base.

Notes to the financial statements

for the year ended 31 March 2018

12. Property, plant and equipment – the railway network (continued)

At 31 March 2018, the company had entered into contractual commitments in respect of capital expenditure amounting to £2,810m (2017: £3,505m).

Change in presentation of government grants

The change in Network Rail's method of presenting government grants (see page 18) in the Balance Sheet, has resulted in the amount previously presented as deferred income now being shown as a deduction in calculating the carrying value of plant, property and equipment. Reconciliation between the old and new method of presentation is as follows:

	2018 £m	2017 £m	2016 £m
Valuation			
Balance under old method	68,373	62,706	58,508
Less: capital grants	(4,256)	(3,525)	(3,168)
Revised balance under new method	64,117	59,181	55,340

13. Investment property

	£m
Valuation	
At 31 March 2016	1,109
Additions	18
Disposals	(27)
Increase in fair value in the year	131
At 31 March 2017	1,231
Additions	4
Disposals	(6)
Transfers from property, plant and equipment	3
Transfers to assets held for sale	(1,142)
Increase in fair value in the year	116
At 31 March 2018	206

The market values of the company's investment properties at 31 March 2018 have been arrived at on the basis of a valuation carried out at that date in conjunction with Jones Lang LaSalle, external valuers not connected with the company. Network Rail undertakes a detailed review of the investment property portfolio to allocate the portfolio to beacons which represent particular groups of property sharing the same characteristics. Network Rail applies yields provided by Jones Lang LaSalle to these beacon categories. Jones Lang LaSalle will also value specific properties, as instructed by Network Rail.

Notes to the financial statements

for the year ended 31 March 2018

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

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

Jones Lang LaSalle provided independent valuations of 6 one-off individual properties (2017: 17), amounting to 35 per cent (2017: 12 per cent) of the total valuation. The balance of the estate was valued under the Beacon method by splitting the portfolio into 13 homogeneous classes (2017: 13) of property and areas, assuming that the current passing rent received from these properties are in line with market rent.

Jones Lang LaSalle independently assessed the appropriate yield to be adopted within each of these classes and areas. This enabled the directors to estimate market values by applying the provided yields to the net rental income from these properties, in accordance with a standard UK investment property valuation.

The property rental income earned by the company from assets categorised at the year end as investment property, all of which is leased out under operating leases, amounted to £15m (2017: £90m). Direct operating expenses arising on the investment properties in the year amounted to £3m (2017: £6m). Rental income and direct operating expenses on assets now classified as held for sale is disclosed at note 15.

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

During the year £1,142m of investment property was transferred to assets held for sale as part of Network Rail's asset divestment program.

14. Inventories

	31 March 2018 £m	31 March 2017 £m
Raw materials and consumables	211	188

As at 31 March 2018 a provision of £20m (2017: £19m) was held in respect of inventories.

Notes to the financial statements

for the year ended 31 March 2018

15. Assets held for sale

In November 2017 Network Rail received clearance from Her Majesty's Government to begin marketing the sale of a substantial part of its investment property portfolio. On 24 November 2017, the assets were transferred from investment property to assets held for sale at their carrying value, as the criteria for reclassification had been met. The value at which the assets were transferred represents the valuation at this date on the measurement basis described in Note 13.

	31 March 2018 £m	31 March 2017 £m
At 1 April	-	-
Transfer from investment property	1,142	-
Transfer from trade and other payables	(11)	-
Additions	3	-
At 31 March	1,134	-

The transfer from trade and other payables relate to tenant bonds which will form part of the disposal of the investment properties.

The property rental income earned by the company from its assets held for sale, all of which is leased out under operating leases, amounted to £81m. Direct operating expenses arising on the assets held for sale in the year amounted to £5m.

16. Investment in subsidiaries

	31 March 2018 £m	31 March 2017 £m
Beginning of year	359	158
Additions in year	-	201
Disposals in the year	(39)	-
End of year	320	359

During the year Network Rail Infrastructure Limited redeemed £39m of its share capital investment in its subsidiary Network Rail High Speed Limited. This share capital redemption is disclosed within disposals.

Notes to the financial statements

for the year ended 31 March 2018

16. Investment in subsidiaries (continued)

Principal subsidiaries affecting the amounts shown in the financial statements are included in the list below.

Directly owned	Country of incorporation	Proportion of issued share capital owned by the company	Principal activity
Network Rail Insurance Limited	Guernsey	100%	Insurance
Network Rail (High Speed) Limited	Great Britain	100%	Holds St Pancras concession and High Speed Railway Services Agreement
Network Rail Development Limited	Great Britain	100%	Holds 49.95% of each of the property joint ventures Solum Regeneration Limited Partnership and Solum Regeneration (Epsom) Limited Partnership
Network Rail Pension Trustee Limited	Great Britain	Company limited by guarantee	Administration of defined contribution pension scheme
Network Rail Consulting Limited	Great Britain	100%	International rail consultancy
Network Rail Certification Body Limited	Great Britain	100%	Conformity assessment services to the rail industry
Network Rail (VY1) Limited	Great Britain	100%	Holds land required for works access
Network Rail (VY2) Limited	Great Britain	100%	Holds land required for works access

The company is a wholly-owned subsidiary of Network Rail Limited, its ultimate parent, company, and is included in the consolidated financial statements of Network Rail Limited which are publicly available. Consequently, the company has taken advantage of the exemption from preparing consolidated financial statements under the terms of section 400 of the Companies Act 2006.

Notes to the financial statements

for the year ended 31 March 2018

17. Trade and other receivables

	31 March 2018 £m	31 March 2017 £m
Non-current assets: other receivables		
Regulatory income receivable	-	37
Current assets: trade and other receivables		
Trade receivables	343	303
Capital grants receivable	163	132
Other taxation and social security	102	130
Other receivables	145	220
Prepayments and accrued income	178	211
	931	996

Trade receivables include an allowance for estimated irrecoverable amounts from the supply of services of £19m (2017: £14m). This allowance has been made by reference to past default experience. Average debtor days were 56 days (2017: 63 days).

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

The company's credit risk is primarily attributable to its trade receivables. Around 95 per cent of the company's income is received from train operating companies and in the form of revenue grants from Government. Franchises are issued to train operating companies by the Department for Transport in England and Wales and Transport Scotland in Scotland. The company believes that amounts receivable from Government and the train operating companies represent a high level of credit quality. This is because in the extraordinary circumstance that a train operating company were to be unable to meet its obligations then provisions in the franchise agreements allow the Department for Transport to take over services at any time. Before accepting any other new customer, the company uses an external credit scoring system to assess the potential customer's credit quality.

Included in the company's trade receivable balance are amounts totalling £92m (2017: £37m) which are past due at the reporting date for which the company has not provided as there has not been a significant change in the credit quality and the amounts are still considered recoverable. The company does not hold collateral over these balances. The average age of these receivables is 13 days (2017: 25 days).

Notes to the financial statements

for the year ended 31 March 2018

17. Trade and other receivables (continued)

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

	31 March 2018 £m	31 March 2017 £m
Past due by 1-28 days	79*	16
Past due by 29-56 days	7	12
Past due by 57-84 days	2	3
Past due by 85-180 days	4	6
	92	37

*£67m past due by 1-28 days relates to amounts owed by the Department of Transport. This amount was settled 18 days after the year end.

Trade receivables of £10m (2017: £11m) are overdue by six months or more, and have been fully provided for.

18. Trade and other payables

	31 March 2018 £m	31 March 2017 £m
Current liabilities: trade and other payables		
Trade payables	505	631
Payments received on account	21	34
Other payables	295	1,525
Other interest accruals	149	132
Other accruals and deferred income	1,545	1,418
	2,515	3,740

In the prior year other payables were significantly higher due to £1,270m relating to Crossrail funding becoming repayable within one year.

The average credit period taken for trade purchases is 27 days (2017: 30 days).

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

Notes to the financial statements

for the year ended 31 March 2018

18. Trade and other payables (continued)

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

	31 March 2018 £m	31 March 2017 £m
Non-current liabilities: other payables		
Capital grants deferred income	145	163
Other payables	136	300
	281	463

Change in accounting treatment

The change in Network Rail's method of presenting government grants (see page 18) in the Balance Sheet, has resulted in the presentation of non-current other accruals and deferred income being represented as a deduction in calculating the carrying value of property, plant and equipment (see note 12). Reconciliation between the old and new method of presentation is as follows:

	2018 £m	2017 £m	2016 £m
Valuation			
Balance under old method	4,401	3,688	3,396
Less: capital grants	(4,256)	(3,525)	(3,168)
Revised balance under new method	145	163	228

Notes to the financial statements

for the year ended 31 March 2018

19. Borrowings

The borrowings balance is split as follows:

	31 March 2018 £m	31 March 2017 £m
Net borrowings		
Cash and cash equivalents	739	609
Intercompany borrowings	(25,588)	(26,742)
Department for Transport facility borrowings	(26,750)	(20,037)
Bank loans	(57)	(48)
	(51,656)	(46,218)
Movements in net borrowings		
At the beginning of the year	(46,218)	(41,559)
Increase in cash and cash equivalents	130	(195)
Net movement in intercompany borrowings	(1,154)	1,590
Increase in borrowings from Department for Transport	(6,713)	(6,097)
Movement in bank loans and overdrafts	(9)	43
At the end of the year	(51,656)	(46,218)
Net borrowings are reconciled to the balance sheet as set out below:		
Cash and cash equivalents	739	609
Borrowings included in current liabilities	(4,652)	(3,202)
Borrowings included in non-current liabilities	(47,743)	(43,625)
	(51,656)	(46,218)

Bank loans related to an external loan from Barclays Bank that was settled in the year.

Notes to the financial statements

for the year ended 31 March 2018

20. Derivative financial instruments

	31 March 2018		31 March 2017	
	Fair value £m	Notional amounts £m	Fair value £m	Notional amounts £m
Non-hedge accounted derivatives				
Forward foreign exchange contracts	0	11	3	43
	0	11	3	43
Included in current assets	0	11	2	39
Included in non-current assets	-	-	1	4
Derivative financial assets	0	11	3	43
Non-hedge accounted derivatives				
Forward foreign exchange contracts	(1)	66	(2)	15
Embedded derivative in inter-company borrowings	(1,050)	32,009	(1,288)	29,908
	(1,051)	32,075	(1,290)	29,923
Included in current liabilities	(1,051)	32,075	(1,288)	29,908
Included in non-current liabilities	-	-	(2)	15
Derivative financial instrument liabilities	(1,051)	32,075	(1,290)	29,923

Notes to the financial statements

for the year ended 31 March 2018

21. Provisions

At 1 April 2017

Additional provision in the year

Utilised in the year

Release for the year

At 31 March 2018

Included in non-current liabilities

The company has provided against a number of claims arising from interpretations of legal contracts or past events for which settlement is expected to be achieved in the next year, but could be deferred to future years depending on the legal interpretation of rights and responsibilities under the contracts as well as commercial negotiation. The provisions that have been recorded represent the directors' best estimate of expenditure required to settle the obligation, with the benefit of legal advice.

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

Contingent liability

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

The company's lawyers have advised that the provisions for the claims are realistic and no provision has been made for contingent liabilities as the directors do not consider there is any probable loss. As envisaged by paragraph 92 of IAS 37 the directors consider that further disclosure regarding the nature and amount of the disputes beyond that disclosed here could be expected to prejudice seriously the position of the company.

Notes to the financial statements

for the year ended 31 March 2018

22. Deferred tax

	Accelerated tax depreciation	Revaluation of railway network	Short term timing differences including retirement benefit obligations	Derivatives	Tax losses	Total
	£m	£m	£m	£m	£m	£m
At 31 March 2016	2,463	609	(254)	-	-	2,818
(Credit)/charge to income	70	-	(18)	-	(10)	42
(Credit)/charge to other comprehensive income	-	(204)	(117)	1	-	(320)
Impact of change in tax rate to income	(133)	-	9	-	33	(91)
Impact of change in tax rate to equity	-	(15)	(15)	1	-	(29)
Utilisation of tax losses previously derecognised	-	-	-	-	(24)	(24)
Transfer between reserves	-	(344)	344	-	-	-
De-recognition of deferred tax asset	-	-	-	(2)	-	(2)
At 31 March 2017	2,400	46	(51)	-	-	2,395
(Credit)/charge to income	10	-	(39)	-	23	(5)
(Credit)/charge to other comprehensive income	-	116	37	1	-	153
Transfer between reserves	-	1	(1)	-	-	-
De-recognition of deferred tax asset (income)	-	-	-	-	(23)	(23)
De-recognition of deferred tax asset (equity)	-	-	-	(1)	-	(1)
At 31 March 2018	2,410	163	(54)	-	-	2,519

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

	31 March 2018 £m	31 March 2017 £m
Deferred tax liabilities	2,572	2,445
Deferred tax assets	(53)	(50)
	2,519	2,395

Notes to the financial statements

for the year ended 31 March 2018

23. Share capital

	31 March 2018 £m	31 March 2017 £m
Authorised:		
50,200,000 ordinary shares of 0.1p each	-	-
500,000,000 redeemable shares of £1 each	500	500
	500	500
Issued and fully paid:		
50,084,937 ordinary share of 0.1p each	-	-
160,000,000 redeemable share of £1 each	160	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.

24. Notes to the statement of cash flows

	31 March 2017 £m	31 March 2017 £m
Profit before tax	219	361
Adjustments for:		
Depreciation of the railway network	1,639	1,515
Amortisation of capital grants	(92)	(81)
Property revaluation movements and profits on disposal	(269)	(205)
Net interest expense	2,069	1,644
Fair value losses on derivatives	(236)	115
Movement in retirement benefit obligations	164	47
Increase/(decrease) in provisions	16	(4)
Operating cash flow before movements in working capital	3,510	3,392
(Increase)/decrease in inventories	(23)	15
Decrease in receivables	101	63
(Decrease)/increase in payables	(47)	80
Cash generated from operations	3,541	3,550

Notes to the financial statements

for the year ended 31 March 2018

25. Operating lease arrangements

The company as lessee

	31 March 2018 £m	31 March 2017 £m
Minimum lease payments under operating leases recognised in the income statement in the year	40	36

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

	31 March 2018 £m	31 March 2017 £m
Within one year	33	33
In the second to fifth year inclusive	98	81
After five years	121	115
	252	229

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

The company as lessor

Operating lease rentals earned in the year by the company were £694m (2017: £650m). This amount includes property rental income of £305m (2017: £292m) as disclosed in note 3.

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

	31 March 2018 £m	31 March 2017 £m
Within one year	444	426
In the second to fifth year inclusive	1,213	1,024
After five years	2,335	2,029
	3,992	3,479

Notes to the financial statements

for the year ended 31 March 2018

26. Funding and financial risk management

Introduction

The company is almost entirely debt funded. Debt has been issued through the special purpose financing company Network Rail Infrastructure Finance plc under the Debt Issuance Programme and loaned to the company through an intercompany loan. The Debt Issuance Programme which is rated AA by Standard and Poor's, Aa1 (outlook negative) by Moody's and AA (outlook negative) by Fitch is supported by a financial indemnity from the Secretary of State for Transport which expires in 2052.

Reclassification of Network Rail

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

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

All of the outstanding bonds under the Network Rail Infrastructure Finance PLC's Debt Issuance Programme, including nominal and index-linked benchmarks and private placements in all currencies, continue to benefit from the direct and explicit guarantee from the UK Government under the Financial Indemnity Mechanism.

In the unlikely event that the DfT withdraws or breaches its obligations on the loan facility to Network Rail Infrastructure Limited, Network Rail Infrastructure Finance PLC may issue further bonds or commercial paper to meet funding requirements.

Notes to the financial statements

for the year ended 31 March 2018

26. Funding and financial risk management (continued)

Externally imposed capital requirements

The company is almost entirely debt financed and therefore manages its debt as the key part of its capital. Network Rail manages its debt in relation to the RAB. This is an important business ratio because the value of the RAB and the amount of debt that the business can sustain are, generally speaking, closely related. Network Rail's debts cannot exceed the value of the RAB; a debt to RAB ratio of significantly less than 100 per cent indicates that the business is more robust to future cost shocks (because it is more likely to be able to service additional debt that may arise from losses incurred).

The regulatory net debt at 31 March 2018 was £50,358m (2017: £44,792m). The RAB is reconciled to property, plant and equipment as follows:

	31 March 2018 £m	31 March 2017 £m
Railway network per note 12	64,117	59,181
Investment properties note 13	206	1,231
Assets held for sale note 15	1,134	-
Other fair value adjustments	1,335	1,341
Regulatory asset base (RAB)	66,792	61,753

The debt to RAB ratio at 31 March 2018 and 2017 was as follows:

	31 March 2018	31 March 2017
Debt : RAB ratio	75.4%	72.5%

The debt to RAB ratio is based on regulatory net debt, which recognises debt at hedged rates.

The company owns and operates Britain's rail network under licence from the Secretary of State. The licence imposes conditions on the company with regard to its net debt. Should the value of the company's qualifying net debt exceed 75 per cent of the ORR's RAB then the ORR will be formally notified. During the year Network Rail received consent from the ORR to exceed the financial indebtedness Debt:RAB ratio.

Notes to the financial statements

for the year ended 31 March 2018

26. Funding and financial risk management (continued)

Summary table of financial assets and liabilities

The following table presents the carrying amounts and the fair values of the company's financial assets and liabilities at 31 March 2018 and 2017.

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

- bank loans – based on market data at the balance sheet date and the net present value of discounted cash flows

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

	31 March 2018		31 March 2017	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial Assets				
Other non-derivative financial assets				
Cash and cash equivalents	739	739	609	609
Investment properties	206	206	1,231	1,231
Assets held for sale	1,134	1,134		
Plant, property and equipment – the railway network	64,117	64,117	59,181	59,181
Trade and other receivables (<i>less prepayments and accrued income and other taxation and social security</i>)	651	651	692	692
Other derivatives		-	2	2
Total financial assets	66,847	66,847	61,715	61,715
Financial Liabilities				
Financial liabilities held at amortised cost				
Bank loans and overdrafts	(57)	(57)	(48)	(48)
Loans from subsidiaries	(25,588)	(25,588)	(26,742)	(26,742)
Department for Transport borrowings	(26,750)	(26,245)	(20,037)	(20,370)
Total borrowings	(52,395)	(51,890)	(46,827)	(47,160)
Trade and other payables	(2,621)	(2,621)	(3,974)	(3,974)
Derivatives				
Embedded derivatives in inter-company borrowing	(1,050)	(1,050)	(1,288)	(1,288)
Other derivatives	(1)	(1)	(2)	(2)
Total derivatives	(1,051)	(1,051)	(1,290)	(1,290)
Total financial liabilities	(56,067)	(55,562)	(52,091)	(52,424)

Notes to the financial statements

for the year ended 31 March 2018

26. Funding and financial risk management (continued)

Derivatives

The company uses derivative financial instruments to reduce exposure to foreign exchange risk and interest rate movements. The company does not use derivative financial instruments for speculative purposes. Certain derivatives are designated as hedges, and those derivatives that are not hedge accounted are fair valued immediately through the income statement. The company has a comprehensive risk management process.

The board of Network Rail Limited (the ultimate parent company of NRIL) through a treasury sub-committee (the treasury committee) have approved and monitor the risk management processes, including documented treasury policies, counterparty limits, controlling and reporting structures.

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

Credit risk

The Network Rail group manages its funds with banks that have high credit ratings; assigned by international credit-rating agencies. The treasury committee authorises the policy for setting counterparty limits based on credit ratings. The group spreads its exposure over a number of counterparties, and has strict policies on how much exposure can be assigned to each of the counterparties. The amount of the investments varies depending on the level of surplus liquidity the company chooses to hold at any point in time. However, because of the strict criteria governing counterparty suitability the risk is mitigated. The treasury committee also authorises the investment and borrowing instruments that can be used.

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

The company considers its maximum exposure to credit risk to be the sum of its financial assets as set out on page 55.

Notes to the financial statements

for the year ended 31 March 2018

26. Funding and financial risk management (continued)

Foreign exchange risk

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

The company considers a ten per cent movement in the value of any currency against sterling would have no material effect on the company's profit before tax or equity due to all currency positions being 100 per cent hedged and therefore no sensitivity analysis is produced.

Interest rate and inflation risk

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

Sensitivity analysis

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

	31 March 2018		31 March 2017	
	Impact on the income statement £m	Impact on equity £m	Impact on the income statement £m	Impact on equity £m
1% increase in the interest rate	320	-	(1028)	-
1% increase in the GBP RPI	(179)	-	(287)	-

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

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

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

Notes to the financial statements

for the year ended 31 March 2018

26. Funding and financial risk management (continued)

Embedded derivatives

The obligations and rights of Network Rail Infrastructure Limited under the inter-company loan agreement with its financing company give rise to an embedded derivative in that agreement which reflects the external currency and interest rates risks to which the financing company is exposed. The embedded derivative is treated as a separate derivative and is accounted for in accordance with the accounting policy disclosed in note 2.

Liquidity risk management

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

The company manages liquidity risk by maintaining sufficient cash and facilities to cover at least one year's working capital requirement by continuously monitoring forecast and actual cash flows.

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

31 March 2018	Within 1 year	1-2 years	2-5 years	5+ years	Total
			£m	£	£
Non derivative financial liabilities					
Inter-company loan	(2)	1	(2)	(52)	(53)
Trade and other payables	(2)	1			(1)
Department for Transport borrowings	(307)	(183)	(102)	(401)	(993)
Derivative financial liabilities					
Embedded derivative	(12)				(12)
Other derivatives					
	(9,168)	(11,364)	(13,827)	(48,015)	(82,374)

Notes to the financial statements

for the year ended 31 March 2018

26. Funding and financial risk management (continued)

31 March 2017	Within 1 year	1-2 years	2-5 years	5+ years	Total
			£m	£	£
Non derivative financial liabilities					
Inter-company loan	28	28	28	(225)	(65)
Bank loans and overdrafts	28	£			28
Trade and other payables					
Department for Transport borrowings	27	20	(130)	20	(25)
Derivative financial liabilities					
Embedded derivative	28		-		28
	(9,146)	(6,196)	(16,514)	(29,507)	(61,363)

Offsetting financial assets and liabilities

a) Financial assets

The following financial assets are subject to offsetting, enforceable master netting arrangements and similar agreements.

31 March 2018

	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the balance sheet	Net amount of financial assets presented in the balance sheet	Related amounts not set off in the balance sheet Financial instruments	Cash collateral received	Net amount
	£m	£m	£m	£m	£m	£m
Derivative financial assets	0	-	0	(0)	-	0

31 March 2017

	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the balance sheet	Net amount of financial assets presented in the balance sheet	Related amounts not set off in the balance sheet Financial instruments	Cash collateral received	Net amount
	£m	£m	£m	£m	£m	£m
Derivative financial assets	2	-	2	(1)	-	1

Notes to the financial statements

for the year ended 31 March 2018

26. Funding and financial risk management (continued)

b) Financial liabilities

The following financial liabilities are subject to offsetting, enforceable master netting arrangements and similar agreements.

31 March 2018

	Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the balance sheet	Net amount of financial liabilities presented in the balance sheet	Related amounts not set off in the balance sheet Financial instruments	Cash collateral paid	Net amount
	£m	£m	£m	£m	£m	£m
Derivative financial liabilities	(1,051)	-	(1,051)	0	0	(1,051)

Network Rail Infrastructure Limited has a collateral obligation of GBP 2.3m which is paid for by Network Rail Infrastructure Finance Plc through the intercompany arrangements.

31 March 2017

	Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the balance sheet	Net amount of financial liabilities presented in the balance sheet	Related amounts not set off in the balance sheet Financial instruments	Cash collateral paid	Net amount
	£m	£m	£m	£m	£m	£m
Derivative financial liabilities	(1,290)	-	(1,290)	1	-	(1,289)

Cash flow hedges

Contractual payments on derivatives designated as cash flow hedges impact the income statement when they occur, and will have all matured within the next ten years.

Notes to the financial statements

for the year ended 31 March 2018

26. Funding and financial risk management (continued)

Fair value measurements recognised in the balance sheet

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

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

As at 31 March 2018:	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Property, plant and equipment – the railway network	-	-	64,117	64,117
Investment property	-	-	206	206
Assets held for sale	-	-	1,134	1,134
Cash and cash equivalents	739	-	-	739
Financial assets held at amortised cost	-	651	-	651
Assets	739	651	65,457	66,847
Derivative financial liabilities	-	(1,051)	-	(1,051)
Financial liabilities held at amortised cost	-	(54,511)	-	(54,511)
Liabilities	-	(55,562)	-	(55,562)
Total	739	(54,911)	65,457	11,285

As at 31 March 2017:	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Property, plant and equipment – the railway network	-	-	59,181	59,181
Investment property	-	-	1,231	1,231
Derivative financial assets	-	2	-	2
Cash and cash equivalents	609	-	-	609
Financial assets held at amortised cost	-	692	-	692
Assets	609	694	60,412	61,715
Derivative financial liabilities	-	(1,290)	-	(1,290)
Financial liabilities held at amortised cost	-	(51,134)	-	(51,134)
Liabilities	-	(52,424)	-	(52,424)
Total	609	(51,730)	60,412	9,291

There were no transfers between Level 1 and 2 during the current and prior year.

Notes to the financial statements

for the year ended 31 March 2018

26. Funding and financial risk management (continued)

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

The company uses an income approach to determine the fair value of the railway network. The methodology uses the discounted future cash flows that are expected to be generated by the railway network, adjusted for forecast performance variations. Further details on this valuation technique are disclosed in note 12.

The fair value of investment property is derived by applying market yields of similar properties in the market to the net rental income of the company's investment property. The valuation is carried out in accordance with a standard UK investment property valuation and performed by external valuers not connected with the company. Further details on this valuation technique are disclosed in note 13.

Valuation technique	Fair value at 31 March 2018 £m	Estimated rental value per sq ft			Equivalent yield		
		Minimum £	Maximum £	Weighted average £	Minimum %	Maximum %	Weighted average %
One-off valuation	73	0.66	336	3.53	3.3	7.0	5.3
Beacon method*	133	n/a	n/a	n/a	5.3	12.0	8.3

* The Beacon methodology splits all the properties within the portfolio into 13 homogenous groups. The properties in each group are valued by applying a yield to the annual rent (passing or void) for the property. Yields applied are on the basis that the property is rack rented i.e. the current passing rent received from these properties are in line with market rent. As such, an estimated rental value per square feet for these properties is not available.

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

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

Notes to the financial statements

for the year ended 31 March 2018

27. Retirement benefit schemes

Defined contribution schemes

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

At 31 March 2018, the NRDCPS had 12,170 members (2017: 10,595) and the average employer contribution rate in the year was 4.3 per cent (2017: 4.3 per cent).

Defined benefit schemes

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

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

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

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

Qualified actuaries Towers Watson have valued the schemes on an IAS 19 (revised) basis at 31 March 2018 and 31 March 2017.

Notes to the financial statements

for the year ended 31 March 2018

27. Retirement benefit schemes (continued)

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

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

The estimated amounts of contributions expected to be paid by the company and members to the schemes during the year ended 31 March 2018 are £114m and £74m respectively. If a surplus or deficit arises, the provisions in the rules mean that the company and members benefit from or pay for this respectively in the proportion 60:40.

	2018	2017
	%	%
<i>Key assumptions used:</i>		
Discount rate		
Expected rate of price inflation and CARE benefit increases (RPI measure)		
Future earnings increases*		
- after changes to benefits from 1 April 2017		3
Future pension increases – RPS (CPI measure)		

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

** 2.9% p.a. for non-Protected members, 3.4% p.a. for Protected members as at 31 March 2016

Notes to the financial statements

for the year ended 31 March 2018

27. Retirement benefit schemes (continued)

	2018		2017	
	Males	Females	Males	Females
Average life expectancy mortality tables used to determine defined benefit obligations:				
- Member aged 65 now (pension under £9,300 pa or pensionable pay under £35,000 pa)	22.1	23.7	21.2	23.0
- Members aged 65 now (others)	22.1	23.7	23.6	24.8
- Member aged 65 in 20 years' time (pension under £9,300 pa or pensionable pay under £35,000 pa)	23.8	25.6	23.6	25.4
- Member aged 65 in 20 years' time (others)	23.8	25.6	25.9	27.2

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

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

	2018 £m	2017 £m
Current service cost – defined contribution (see note 6)		
Current service cost – defined benefit (see note 6)	273	196
Past service credit - defined benefit (see Note 6)		(42)
Interest cost	5	4
	330	196

The current service cost has been included in employee costs, the net interest scheme deficit has been included in finance costs. The past service credit has arisen in the year due to pension scheme changes that limited the way that above-inflation pay increases count towards defined benefit pension obligations.

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

	2018 £m	2017 £m
(Gain)/loss on defined benefit obligation due to experience	(31)	(81)
(Gain)/loss on defined benefit obligation due to assumption changes	(132)	1,292
Return on plan assets greater than discount rate	(58)	(412)
Total (gain)/loss recognised in the statement of comprehensive income	(221)	799

The cumulative amount of actuarial losses recognised in other comprehensive income was £1,488m (2017: £1,709m).

Notes to the financial statements

for the year ended 31 March 2018

27. Retirement benefit schemes (continued)

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

	2018 £m	2017 £m
The defined benefit obligation is made up as follows:		
Active members	£	£
Deferred pensioner members	£	£
Retired members	£	£
Present value of defined benefit obligation	(12)	(12)
Fair value of scheme assets	1	1
Deficit in the scheme	£	£
Company's share (60%) of the scheme deficit recognised in the balance sheet	£	£

This amount is presented as a non-current liability in the balance sheet.

Cumulative gains or losses are recognised in equity.

Expected future benefit payments from the Network Rail Section, based on data from the 2013 formal valuation and the 31 March 2018 IAS19 assumptions are as follows:

	£m
Benefits expected to be paid within 12 months	182
Benefits expected to be paid between 2 to 3 years	404
Benefits expected to be paid between 4 to 6 years	709
Benefits expected to be paid between 7 to 10 years	1,144
Benefits expected to be paid between 11 to 15 years	1,737
Benefits expected to be paid in over 15 years	12,129

Notes to the financial statements

for the year ended 31 March 2018

27. Retirement benefit schemes (continued)

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

	Assets*	Liabilities**	Deficit
	£m	£m	£m
At 1 April 2016	5,375	(7,742)	(2,367)
Current service cost including members' share	–	(314)	(314)
Interest on pension deficit	183	(259)	(76)
Administration expenses	(8)	–	(8)
Return on plan assets greater than the discount rate	687	–	687
Section amendment	–	70	70
Actuarial gain arising from experience adjustments	–	135	135
Actuarial loss arising from financial assumptions	–	(2,155)	(2,155)
Regular contributions by employer	107	–	107
Contributions by employees	69	–	69
Benefits paid	(182)	182	–
At 1 April 2017	6,231	(10,083)	(3,852)
Current service cost including members' share	–	(440)	(440)
Interest on pension deficit	156	(249)	(93)
Administration expenses	(11)	–	(11)
Return on plan assets greater than the discount rate	97	–	97
Actuarial gain arising from experience adjustments	–	52	52
Actuarial loss arising from demographic assumptions	–	219	219
Regular contributions by employer	107	–	107
Contributions by employees	70	–	70
Benefits paid	(193)	193	–
At 31 March 2018	6,457	(10,308)	(3,851)

*Including CARE scheme assets at 31 March 2018 of £214m (2017: £198m)

**Including CARE scheme liabilities at 31 March 2018 of £476m (2017: £377m)

The actual return on scheme assets was £253m (2017: £794m).

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

	Fair value of assets		Percentage of assets	
	2018	2017	2018	2017
Equity instruments	5,714	5,509	88.49	88.41
Debt instruments - Government	472	417	7.31	6.69
Debt instruments – non-Government	265	259	4.10	4.16
Property	6	7	0.10	0.11
Other	–	39	–	0.63
	£	£		

Notes to the financial statements

for the year ended 31 March 2018

27. Retirement benefit schemes (continued)

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

Asset volatility

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

Change in bond yields

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

Inflation risk

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

Life expectancy

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

Actuarial assumption sensitivity

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

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

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

Notes to the financial statements

for the year ended 31 March 2018

27. Retirement benefit schemes (continued)

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

	2018 £m	2017 £m
Discount rate		
Change in defined benefit obligation at year end from a 25 basis point increase	62	(4)
Change in defined benefit obligation at year end from a 25 basis point decrease	5	2
Mortality		
Change in defined benefit obligation from a one year increase in longevity	2	3
Change in defined benefit obligation from a one year decrease in longevity	(2)	(3)
Earnings increases		
Change in defined benefit obligation at year end from a 25 basis point increase	1	1
Change in defined benefit obligation at year end from a 25 basis point decrease	(1)	(1)
Price inflation (CPI measure)*		
Change in defined benefit obligation at year end from a 25 basis point increase	5	522
Change in defined benefit obligation at year end from a 25 basis point decrease	(1)	(1)

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

Notes to the financial statements

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28. Related parties

	2018 £m	2017 £m
Loans to subsidiaries and immediate parent company		
Network Rail Development Limited	1	1
Network Rail Consulting Limited	1	1
Network Rail (VY1) Limited	1	1
Network Rail (VY2) Limited	1	1
	1	1

Loans to joint ventures

The Station Office Group	1	1
West Hampstead Limited Partnership	1	1
	1	1

The amount repayable from Network Rail Development Limited is considered as long-term funding and used to invest in joint ventures; Solum Regeneration (GP) Limited and Solum Epsom (GP) Limited. No interest is charged on the loan.

Loans from subsidiaries

	2018 £m	2017 £m
Network Rail Infrastructure Finance PLC	(25,645)	(26,742)

As the company's sponsor, the Department for Transport (DfT) is considered a related party. Network Rail received grant income of £4,480m from the DfT in the year ended 31 March 2018 (2017: £3,916m). The company also paid the DfT £281m in respect of the Financial Indemnity Mechanism fee (see note 25 for more details). At 31 March 2018 the company held £26,750m of loans issued by DfT (2017: £20,037m).

The British Transport Police (BTP), with whom Network Rail has a Police Service Agreement is also a related party. Network Rail incurred £93m (2017: £90m) of costs relating to services provided by the BTP in the year ending 31 March 2018 and received £1m (2017: £1m) in property income from the BTP in the same period.

Network Rail is also a related party of High Speed 2 (HS2). At the end of the financial year Network Rail held £73m (2017: £45m) of capital work in progress relating to works on HS2 and had also received £50m (2017: £39m) of capital grants that was recorded against property, plant and equipment.

Notes to the financial statements

for the year ended 31 March 2018

28. Related parties (continued)

Ultimate parent company

The company's ultimate parent company and controlling entity is Network Rail Limited, a company limited by guarantee without shares. The company's immediate parent company is Network Rail Holdco Limited. Both parent companies are incorporated in Great Britain and registered in England and Wales. The largest group of undertakings of which the company is a member and for which group financial statements are drawn up is Network Rail Limited. Only Network Rail Limited produce consolidated financial statements. Copies of the ultimate parent company's financial statements can be obtained by contacting the company secretary at 1 Eversholt Street, London, NW1 2DN.

29. Post balance sheet events

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