

Directly Operated Railways Limited
Annual Report and Financial Statements
For the year ended 31 March 2012

Company Number 06950819

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London
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Annual Report and Financial Statements
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**Directly Operated Railways Limited
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Directors**

Chairman	Doug Sutherland
Chief Executive	Michael Holden
Directors	Andy Cope David Walker Robert Mason
Company Secretary	David Walker
Registered Office	4 th Floor One Kemble Street London WC2B 4AN
Independent Auditors	PricewaterhouseCoopers LLP Chartered Accountants and Statutory Auditors 1 Embankment Place London WC2N 6RH

**Directly Operated Railways Limited
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Chairman's Statement**

I have pleasure in presenting the report and audited financial statements for the year ending 31 March, 2012

These results reflect the second full year of operations for Directly Operated Railways Limited ("DOR") (the "Company") and of East Coast Main Line Company Limited ("East Coast"). By delivering these results, DOR has achieved the objectives set for the Company by the Department for Transport ("DfT")

During the year, East Coast has made good progress with the turnaround of the Company. The achievements to date have been significant, including major enhancements such as the introduction of an extensive timetable change in May 2011, the introduction of a new complimentary catering offer to improve the value of the First Class product, also in May 2011, together with the launch of a new 'Welcome' theme, and enhancements to East Coast's depots and fleet projects such as a remote condition monitoring system which enables the constant and real-time analysis of individual train performance whilst the fleet is in service.

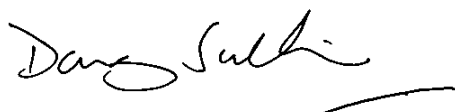
During the year, the Department for Transport indicated that East Coast would be returned to private sector ownership in December 2013 and after the year-end, it published a timetable for the process of franchise change which would see the initial stakeholder consultation for this work commence in summer 2012.

A good deal more needs to be done in the remaining term of the current franchise, embedding the good foundations that have now been established. During 2012/13, DOR will continue to seek opportunities to enhance the value of its business and to meet all DfT objectives. It will continue to deliver service improvements and innovations for the benefit of East Coast customers, and the taxpayer at large, and also drive a continuous improvement of standards for staff across the operation.

Throughout the recent period of substantial change to the East Coast business in 2011/12, the Company has delivered a credible financial performance, despite the continuing downturn in the economy, and it has also made significant improvements in safety standards.

During the year, Elaine Holt stepped down as Chairman and Chief Executive of East Coast, and the Board acknowledges her significant contribution in steering the business through a period of substantial change, since she joined the Company in July 2009.

Notwithstanding prevailing market conditions, I am confident that the plans we have put in place will enable the Company to achieve sustainable growth during the year ahead.



Doug Sutherland
Chairman
21 June 2012

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Board of Directors**

Michael Holden started his early career with British Rail as a traffic student in 1974. He later became Divisional Operations Manager for the South West Division of Network South East, and in 1994, joined the newly created Railtrack as Production Manager for the South West Zone. He was then appointed Zone Director for East Anglia, and finally Regional Director Southern. In 2003 he became Managing Director of Connex South Eastern, and immediately found himself negotiating the transition from that franchise into a period of public sector ownership. He created South Eastern Trains and ran it successfully until it was re-franchised in April 2006. A railway management consultant, he specialises in providing strategic advice to clients and leading bid teams for franchise, concession and PFI competitions.

Doug Sutherland is a Chartered Management Accountant who has held senior finance roles with Black & Decker, Grand Metropolitan and Dairy Crest. In 1995 he moved to the public sector, initially as Managing Director Finance for North of Scotland Water and then Managing Director Finance and Commercial for the Strategic Rail Authority. He served as Chairman of South Eastern Trains (Holdings) during its period of public ownership, and from 2006 to 2010 was a Non-Executive Director of OPD and is currently Chairman of BRB (Residuary).

Andy Cope is a Chartered Engineer who started work as an apprentice with the Birmingham Division of British Rail in 1972. His first job was as a fitter at Oxley Depot, Wolverhampton. He became a Supervisor at Duddeston Carriage in Birmingham, and then went to Derby working in the regional headquarters technical organisation. From there he spent five years as Shift Manager at Craiginny train depot near Edinburgh, before moving to Bristol as Depot Engineer at St Philips Marsh. Following a period as Head of Engineering Production for First Great Western, he established the engineering function at First Capital Connect and became their first Engineering Director. Andy Cope is committed to the development of people in the business, and the championing of engineering techniques as an asset for every train operating company.

David Walker is a Fellow of the Chartered Association of Certified Accountants, who started his career with the National Coal Board. Then in 1979 he joined the then Trusthouse Forte Group initially as Management Accountant. David progressed through a number of senior financial positions before taking the position of Group Financial Controller with The Forte Group. In 1995 he joined Railtrack as Financial Controller of the East Anglia Zone before moving to the Southern Region as Business Development Manager, subsequently he was appointed as Investment Manager with responsibility for the development and delivery of all infrastructure projects across the Southern Region, transferring to Network Rail in 2002. In 2004 David joined the Scanmoor Group as Managing Director of its Rail Division and then set up and was appointed as Managing Director of its Romanian Division in 2005. Since 2007 he has run a number of business activities in the UK and Romania.

Robert Mason has over 30 years' experience in the rail industry and holds a degree in Mathematics and Statistics and a Masters Degree from the Business School at Imperial College, London. Rob is a marketing expert in UK railways having held central directing roles in many of the more innovative advances made by passenger railways. In the run up to privatisation, Rob was the British Rail Director of Privatisation Studies helping to set the framework for the franchised railways and subsequently set up Gatwick Express as the first stand-alone passenger railway company where he was Managing Director. He carried out an interim role with the Strategic Rail Authority as the Franchise Director for the Western Region. He has been involved in developing marketing and commercial strategies for several franchise bids in the UK. He has worked with Directly Operated Railways on the transfer of the East Coast franchise and in leading a review of pricing opportunities.

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Directors' Report

The Directors present their annual report, business review, the consolidated financial statements and auditors' report for the year ended 31 March 2012

History and background

DOR ("the Company") is a limited company which was incorporated on 2 July 2009 by the Secretary of State for Transport to manage Train Operating Companies that are returned to temporary public ownership. On 14 November 2009, following termination of the NXEC Trains Limited (NXEC) Franchise Agreement, DOR took over the management and operation of the business, now East Coast, and its principle activity is the management and support of train companies that are returned to temporary public ownership.

The Company is wholly owned by the Secretary of State for Transport and has one wholly owned subsidiary, East Coast. DOR is the intermediate holding company.

DOR and East Coast comprise the Group (the "Group")

Change of name

On 15 July 2009 the Company changed its name from Directly Operated Railway Limited to Directly Operated Railways Limited.

Results and dividend

The Group's reported financial performance for the year ended 31 March 2012 shows a profit on ordinary activities after tax of £4,981,000 (2011: £4,058,000). This performance incorporates the results of East Coast for the year ended 31 March 2012.

The Directors do not propose a dividend for the year (2011: £nil) and there were none paid during the year.

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 below:

Elaine Holt	Chairman and Chief Executive	Resigned 23 December 2011
Michael Holden	Chief Executive	
David Walker	Finance Director	Appointed 17 January 2012
Doug Sutherland	Non-Executive Chairman	
Andy Cope	Non-Executive Director	
Robert Mason	Non-Executive Director	Appointed 24 April 2012

Michael Holden was appointed Chief Executive and Doug Sutherland Non-Executive Chairman on 23 December 2011. Prior to this they had both served as Non-Executive Directors. David Walker was appointed as Finance Director on 17 January 2012. This role was previously undertaken by the Financial Controller, who was not a Director of the Company.

The remuneration of the Directors for the year ended 31 March 2012 is as follows:

	Salary/fees	Pension contributions	Year ended 31 March 2012	Year ended 31 March 2011
	£'000	£'000	£'000	£'000
Elaine Holt	175.1	32.8	207.9	236.2
Michael Holden	156.1	-	156.1	71.1
David Walker	46.5	-	46.5	-
Andy Cope	87.6	-	87.6	88.9
Doug Sutherland	25.0	-	25.0	25.0
	490.3	32.8	523.1	421.2

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The figures above include services provided by Directors to East Coast of £134,325 (2011 £98,300)

Employees

The Group seeks to adhere to the principles of good governance as appropriate for a Group of its size and operations

The Company is a non-discriminatory employer operating an Equal Opportunities Policy which aims to eliminate unfair discrimination, harassment, victimisation and bullying. The Company is committed to ensuring all individuals are treated fairly, with respect, and are valued irrespective of disability, gender, race, health, social class, sexual preference, marital status, nationality, religion, employment status, age or membership or non-membership of a trade union.

The Company's policy is to continue to employ those who become disabled in service, together with some recruitment where circumstances permit. Training is adjusted to cater for an individual's disability and they share the same conditions of service as other staff in relation to career development and promotion.

The Company is committed to employee engagement and uses a variety of methods to inform and consult with its employees. These include the Company newspaper entitled 'Coast Life' and m@inline, the Company intranet. Informal communication across the Company includes briefings and meetings with staff supported by posters and weekly bulletins. The Company has regular dialogue with employees and representatives from trades unions.

Charitable and political donations

The Group made charitable donations totalling £18,893 during the year ended 31 March 2012 (year ended 31 March 2011 £23,790). These include £15,000 in respect of National Rail Chaplain services, £3,031 for The Railway Children, £500 for the British Transport Pensioners Federation memorial fund and £362 for the MS Society. There were no political donations made in the year (year ended 31 March 2011 £nil).

Supplier payment policy

It is the Company's policy to agree terms of payment prior to commencing trade with any supplier and to abide by those terms based on the timely submission of invoices.

Chairman and Chief Executive

During the period until the 23 December 2011 the Chairman acted in the combined full time role of Chairman and Chief Executive. In her capacity as Chairman, Elaine Holt had particular responsibility for formulating DOR's strategy and for ensuring that the Board, in reaching its decisions, takes proper account of guidance provided by the Secretary of State and the Department for Transport. As Chief Executive, Elaine Holt acted as the Accounting Officer of DOR. In this capacity, she was personally responsible for safeguarding the public funds for which she had charge, for ensuring regularity and propriety in the handling of those funds, and for the day to day operation and management of DOR.

On the 23 December 2011 the two roles were separated and Doug Sutherland was appointed as Non – Executive Chairman of the Company. In this role Doug Sutherland is responsible for ensuring a sound governance framework is followed and all board decisions take full account of guidance provided by the Secretary of State and the Department for Transport.

All other responsibilities were transferred to Michael Holden who was appointed as Chief Executive on 23 December 2011. This includes the formation and implementation of the strategies of DOR, acting as Accounting Officer (which has the same responsibilities as detailed above) and the day to day operation and management of DOR.

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The Board of Directors

The Board currently consists of the Non-Executive Chairman, two Executive Directors in the Chief Executive and the Finance Director together with two further Non-Executive Directors. It meets at least twelve times each year and is responsible for monitoring the operational and financial performance of the Company and its subsidiary, East Coast, reviewing progress against the Company's budgets and setting and reviewing its business plans.

The Board of the Company met on thirteen occasions in the year ended 31 March 2012.

The Directors are satisfied that the current Board has the breadth of business, financial and operational experience necessary to manage effectively an organisation of the size and type of the Company.

Information and Board development

The Board receives detailed briefing papers and reports on the business to be conducted at each meeting one week in advance of the meeting.

All Directors have access to the advice and services of the Company Secretary and, if necessary, can seek independent professional advice at the Company's expense in the furtherance of their duties.

Directors receive induction training on appointment to the Board which is tailored to their individual needs and experience. Information is provided to Directors on their responsibilities, regulations and legal obligations.

Audit Committee

The Group Audit Committee is chaired by Doug Sutherland and includes Robert Mason and Andy Cope. Michael Holden (Chief Executive of DOR) and David Walker (Finance Director of DOR) also attend meetings of this Committee when appropriate.

The Committee met three times during the year. The Company's external and internal auditors are invited to attend all meetings of the Committee.

Under its terms of reference the Committee keeps under review the Company's internal and external financial statements and reports to ensure that they reflect best practice.

The Committee ensures that the internal audit department has appropriate access to information to enable it to perform its function effectively and in accordance with relevant professional standards, and that it has adequate standing within the Company. It considers audit reports on the Company from the internal auditors and reviews and monitors management's responsiveness to the findings and recommendations.

The Committee is responsible for making recommendations to the Board in respect of the appointment and re-appointment of the Company's external auditors and recommends to the Board the audit fee to be paid to the external auditors.

Remuneration Committee

The Group Remuneration Committee is chaired by Doug Sutherland and includes the Non-Executive Directors. The Executive Directors attend as required.

This group met a number of times during the year to agree the terms and conditions of the Executive Directors.

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Directors' Report

Directors and their interests

The current Directors of the DOR Board are listed on page 5. A Register of Directors' Interests is maintained by the Company Secretary through whom public inspection can be arranged. Doug Sutherland, Robert Mason and Andy Cope are Non-Executive Directors. None of the Directors have any interests, such as shares in the companies within the Group.

Financial reporting

The Directors have a commitment to best practice in the Company's financial reporting and systems. A statement of the Directors' Responsibilities for preparing the financial statements may be found on page 16.

Directors' and Officers' liability insurance

The Company has Directors' and Officers' liability insurance cover in place as permitted by the Companies Act 2006.

Internal controls

The Board is responsible for establishing the Company's goals and objectives, and overseeing the establishment, implementation and review of the Company's risk management system. The Company has in place a risk management policy, the purpose of which is to ensure that risk management is an integral part of day-to-day operations for all staff.

The Board is also responsible for maintaining a sound system of internal control that supports the achievement of these goals and objectives. It sets appropriate policies on internal control and seeks regular assurance its policies are being complied with and that the system is functioning effectively.

The system of internal control is designed to manage risk rather than eliminate it completely and can only provide reasonable, rather than absolute assurance against material misstatement or loss.

Operating and financial review

Operating review – business overview

Since DOR acquired the East Coast franchise from National Express in November 2009, the Company's primary objective has been to ensure that it meets its obligations to the DfT under a *Deed of Services* (similar to a conventional rail Franchise Agreement) as well as achieving best value for money for the taxpayer. The business is tasked with improving both the short and longer-term value of the East Coast franchise and its business plans are designed to support this objective.

The Company's strategy continues to focus on the completion of the turnaround for one of the UK's premier rail routes and ensuring that the business is improved significantly before it is returned to the private sector. This is now currently expected to be in December 2013, which is longer than the timescale initially anticipated. During the year, the East Coast business has focussed significantly on improving safety performance, establishing a much closer working relationship with Network Rail to make a step change in operational performance and focussing on the customer service experienced by passengers. Another key focus of the business is the improvement of operational performance. While significant progress has been made in the year, much remains to be achieved in this area.

East Coast has achieved significant success over the last two years which has set the business on a positive trend across many areas of the Company. This success was reflected during the year by that fact that the business was the recipient of no fewer than nineteen industry awards between April 2011 and March 2012.

The new timetable

On 22 May 2011 East Coast introduced the most significant timetable change in the last 20 years on the East Coast Main Line. This has seen nineteen additional services each weekday, three million

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extra seats and faster journey times on services across the network. The new four-hour Flying Scotsman is the flagship services in East Coast's new timetable and there are now direct daily services to and from Lincoln.

The new complimentary food offer

To coincide with the release of the new timetable on 22 May 2011, the Company introduced a new at-seat complimentary food and drink offer in First Class. Customer research carried out in 2010 suggested that more customers were likely to 'trade-up' from Standard to First Class if there was improved value and a better offer. As a result the Company has gone from serving typically 100,000 meals per year to more than a million.

The timetable change, coupled with the development and introduction of the new First Class offer, has meant one of the biggest change programmes the Company has seen.

To date, both the timetable and the new first class offer have been heralded as significant successes for the business. The new timetable was introduced seamlessly, and since the introduction of the complimentary food and drink offer in First Class, passenger numbers have increased overall by 21% in First Class during the year, with numbers on the flagship London-Edinburgh route increasing by as much as 39%.

Customer satisfaction

East Coast customer satisfaction has improved over the past year, with positive feedback received about the changes made to enhance the customer journey experience.

In the Spring 2012 National Passenger Survey East Coast achieved 89%, a 2% improvement over the previous result and the best result since Spring 2006.

Safety and environment

Safety remains the top priority at East Coast. The benefits of new initiatives and programmes introduced early in 2010 and 2011 are now starting to be realised. These included the introduction of safety summits, and safety culture workshops. Functional safety plans have been introduced, as well as improved safety management systems, more safety training, and better risk management procedures.

At the time of handover to East Coast in November 2009, safety performance had been deteriorating, targets were not being met, operational incidents were increasing and there was a poor safety 'culture' in the business.

During 2011/12, there have been continuing improvements in both occupational and operational safety – with many areas showing a significant year on year improvement. East Coast is now one of the best safety performers in the rail industry.

The Boards of both DOR and East Coast place a primary focus on ensuring that their safety responsibilities are met in full, and that East Coast continues to operate at all times within a safe railway environment.

Occupational Safety Performance highlights in 2011/12 compared to the previous year show

- All passenger accidents 35% better
- Major passenger accidents 81% better
- All staff lost time accidents 20% better
- High risk SPADs 57% better
- Safety vehicle defects 31% better

The 2011/12 Safety Improvement Plan was based around the delivery of four themes containing 17 generic objectives and a further 27 objectives aimed at improving safety within the Engineering, Operations, and Customer Services functions.

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The large majority of objectives of the Plan were delivered in 2011/12. In particular, East Coast has

- Ensured the safe implementation of the May 2011 timetable change and the delivery of the new First Class catering offer,
- Developed safety training across the business,
- Increased the use and effectiveness of 'risk walls' and 'safety plans' within the main operational functions,
- Reviewed, and where necessary, enhanced train dispatch risk assessments,
- Extended the number and use of train driving simulators,
- Improved the ability to respond to operational accidents,
- Improved the management of third party suppliers of safety critical products and services, and
- Introduced a new electronic 'safety briefing' process for staff

Safety Plan 2012-14

A new Safety Plan for 2012-14 was introduced in April 2012, and during the coming year East Coast will focus on continuous improvement in every area. It will strive for further year-on-year improvement in safety performance and deliver industry best safety practice.

It will further develop its functional plans for Engineering, Operations and Customer Services through the development of additional safety culture and leadership development initiatives, and through training and competence assessment.

The targets for 2012-14 have been adapted to take account of the improvements realised in 2011/12. The new Plan also includes the safety objectives underpinning the delivery of these targets.

Environment

At the start of 2011, East Coast focussed on keeping track of its energy use, initially relying on estimates from utility companies to calculate how much energy and water were used each month. 'Smart' utility meters installed at larger East Coast sites now alert managers to inefficient use or equipment that has been left on. This has helped the business to save 8.2% in annual energy use at the headquarters in York, and almost 30% in a pilot scheme at Clayhills Depot, near Aberdeen.

Recycling

Over the same period, East Coast has increased the proportion of recycled waste from less than 10% in 2011, to over 28% by the year-end in March 2012. At the York headquarters, 83% of all waste is now recycled. A total of 55% of on-board waste arising from our turnaround services at Kings Cross.

Noise and pollution prevention

With three urban depot sites, one challenge has been to prevent pollution and reduce the impacts of noise from train maintenance operations. East Coast has worked closely with Network Rail and its depot teams to improve maintenance regimes for pollution prevention equipment. Good performance is now achieved across all depot sites. The focus in 2012-14 will be on managing and reducing the effect of noise on East Coast's neighbours.

The Company has developed many of the systems and procedures required for accreditation to formal 'ISO' management standards for environment and energy, including an 'on-line' repository of legal consents, environmental licenses and permits.

East Coast has also retained its ISO14001 accreditation for depots and support service functions.

The Environment Plan 2012-14 takes into account the progress and knowledge gained in relation to environmental performance in 2011/12. The development of an 'environmental toolkit' will provide the mechanism for improvement and will allow the Company to demonstrate high levels of diligence, performance and staff engagement prior to re-franchising in December 2013.

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Staff

Staff remain at the heart of the service offered by East Coast to the near nineteen million customers served each year by the Company. The last two years have seen substantial change for staff, whilst the remaining period until franchise in December 2013 will see consolidation of achievements, continuing to find efficient ways of doing things better.

During the year staff morale has continued to improve following a low point at the time of handover. Focused plans for the business, the introduction of the new timetable and on-board service and much needed investment in almost every part of East Coast has meant that job satisfaction levels have continued to improve. The continuing reduction in sickness absence is also a positive sign, and another significant indication that the pride is returning. The fact that the franchise will now continue until December 2013 provided a further boost to staff.

Sickness absence

The average number of sickness absence days per employee per year stood at over 14 immediately prior to handover in November 2009. The implementation of a new sickness absence plan has seen levels continue to fall consistently year-on-year, and by the end of March 2012 this figure had reduced to just under 9 days (31 March 2011: 11 days). Work will continue during 2012/13 to drive this figure further downwards.

Total number of employees

During the year, overall staffing levels showed a modest increase, largely due to some additional personnel recruited in connection with the delivery of the new timetable and on-board First Class offer. The actual number of staff employed at the end of March 2012 was 2,874 (end of March 2011, 2,818).

Turnover of staff

During the year, the turnover of staff has reduced from 5.13% to 3.89%. The Company has Investors in People accreditation for a further year, and Performance Development Review's and Time for You processes for managers and staff introduced in 2010 continue to work well, aligning with the Company's vision, values and its seven strategic goals.

Performance

Operational performance has been a continuing concern for the Board during the year.

East Coast had been consistently at the bottom of the national PPM (Public Performance Measure) table during 2011/12, although towards the end of the year there were signs that this position was improving, and the Moving Annual Average had risen above 86%. Delay minutes outside of East Coast's control remain however the largest proportion of delay, although East Coast has also not met the TOC on self target and has caused increasing delay to other operators and their customers. The number of fatalities on the East Coast Main Line is an issue of continuing concern, and this factor was a significant cause of delays.

There have been successes in performance including the strengthening of the relationship with Network Rail and the level of analysis to understand how performance has taken a step forward.

Improving infrastructure resilience

With typically four-fifths or more of delays still caused by external factors, East Coast has been examining ways with Network Rail to ensure a step-change in the reliability of its assets – and to ensure that it remains sustainable.

Over the last decade or so some £9 billion has been invested in the West Coast Main Line. However, the East Coast Main Line has not benefitted from anything like a similar level of investment, and as a consequence, the scale of renewal has lagged behind. On a route that is almost 920 miles in length, the systematic replacement of track and line-side equipment, including many of the elements that have the potential to cause delays (such as signalling and overhead power lines) when they fail, is a big task. The Board is encouraged that the new devolved management structure with Network Rail London

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Directors' Report**

North Eastern is starting to sharpen focus and to improve harmonised working. There are now tangible signs that the closer joint working with Network Rail during the year is beginning to deliver better operational performance in a number of areas.

Plans for the renewal of such essential equipment is now starting to be addressed and the Board is also pleased that Network Rail has been able to bring forward some additional investment funding to help achieve this.

A new two year Joint Performance Improvement Plan (JPIP) has now been agreed that will demonstrate how both Network Rail and East Coast are planning to meet future expectations. To improve focus and underlying performance, the JPIP focuses on a detailed set of measures including incident count, Right Time starts, Right Time arrivals and significant lateness.

Business Disruption Centre

A new facility was developed during the year at the York headquarters of East Coast, designed to provide both strategic and tactical support during times of severe disruption. The Business Disruption Centre has been used on a number of occasions during the latter half of the year (especially during the high winds and winter snow at the turn of the year) and has contributed to a significant improvement in the ability of East Coast to manage disruptive events more effectively for customers.

Engineering and fleet

As part of the East Coast turnaround, which started early in 2010, the Engineering function has been substantially re-organised and significant advances have been made. This includes a revitalised Engineering Management System and a review of maintenance practice.

The lack of investment in previous years has been reversed, and as a consequence, this investment has started to translate into improved performance.

Despite the age of the East Coast train fleet, the investment has continued during the year and several projects have been implemented that will improve the efficiency of the engineering function, and in particular, the introduction of a remote system that monitors the condition and functions of each train whilst it is in service. This helps to realise problems that might have further impacts if they remained unchecked, and for the depots to be ready to undertake specialist remedial work when the train returns for routine maintenance.

Whilst Directly Operated Railways will not be the shareholder of the business in the future, decisions made now will affect the future operation of the franchise. As a consequence, East Coast is focused on

- A market testing review to look at the options for either life extending, replacing the locomotives, or the entire replacement of the MKIV 225 electric fleet, and
- A replacement of the HST diesel fleet.

This will enable a range of information to be available for bidders of the new franchise so that decisions can be taken at the earliest opportunity on this ageing fleet.

Both the HST Diesel trains and the MKIV 225 electric fleets have leases terminating by 2015 and to ensure best value for money for lease extensions, East Coast will need to complete successful negotiations in 2012.

The DfT is due to make a decision in the summer of 2012 on the replacement of the HST fleet under the InterCity Express Programme, which will ultimately see the delivery of a brand new fleet of trains for East Coast from 2019.

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Directors' Report

Projects

The year saw the completion and/ or substantial completion of a number of major projects. These included

- Substantive preparations for the introduction of the new timetable and First Class complimentary food and drink offer,
- Edinburgh, new travel centre,
- The completion of the new Western Concourse at King's Cross, including a new East Coast operated travel centre, First Class Lounge, and staff accommodation, and
- New cycle access routes at York station

The following projects are expected to be completed or substantially advanced during 2012/13

- Peterborough station re-development, and
- Wakefield station re-development

Summary

Guided by Directly Operated Railways, East Coast made significant progress during the year on its turnaround. A completely new and enhanced timetable was introduced with a complementary catering offer in first class, customer service was improved, safety outputs improved, assets have been worked harder, and solid financial performance achieved in a challenging economic environment. Many improvements were made to managerial capability across the business, and foundations were built for improved engineering and operational performance. Investment was made in facilities, equipment, systems and people, and improved processes were put in place to ensure clear measurement and effective control exists across the business.

The business plan for April 2012 to the end of the franchise will see this work continuing, with the twin aims of ensuring a successful transfer of the business back to the private sector in good condition and maximising the value achieved by the government at re-franchising.

Operating review - financial review

Operating performance

Turnover for the year ending 31 March 2012 amounted to £665.8m (2011: £645.5m) which in the main reflects ticket revenue earned from passenger services at East Coast and associated income earned from catering, car parks and commission from the sale of tickets on other train operators' services.

The operating expenditure reported in the period was £661.0m (2011: £641.3m), comprising access charges payable to Network Rail for stations and depots, rolling stock lease costs, staff costs and other operating costs, generating an operating profit before DfT Service Payments and taxation of £195.7m (2011: £182.8m) and an operating profit after DfT Service Payments before taxation of £7.1m (2011: £6.5m).

During the year general economic market conditions continued to have had a significant effect on East Coast's passenger revenue, with year on year growth of 3% which is slightly behind overall industry comparators. This weaker performance reflects the disparity in the economic conditions in regions served by East Coast which have fallen behind the rest of the country, particularly London and the South East.

Balance sheet

At 31 March 2012 the Group had net assets of £7.0m (2011: £2.5m) and the Company, net liabilities of £1.9m (2011: £1.1m).

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Cash flow

The Group has incurred a net cash outflow of £36.4m in the year (2011: £15.4m inflow) leaving a cash balance of £24.7m at 31 March 2012 (2011: £61.0m)

On 11 November 2009 the Company entered into a £40m Working Capital Facility Agreement between the Secretary of State for Transport, the Company and its subsidiary, East Coast. This facility was entered into for the purposes of ensuring the Company has the necessary funding in place to meet its supplier commitments during the first six months following incorporation and to enable East Coast to satisfy its obligations under the Service Agreement following commencement of delivery of passenger rail services from 14 November 2009 onwards. During the year the Company repaid £11m under this facility which has resulted in £10m outstanding at the year end to the Secretary of State for Transport.

Key risks and uncertainties

There are a number of potential risks and uncertainties that could have an impact on the Company's performance and objectives:

(a) Legislation and regulation

The Company is subject to numerous laws relating to safety procedures, equipment, employment, environmental initiatives and procedures and other operating issues and considerations. These laws and regulations are subject to alteration and amendment and the costs of compliance with new legislation and regulations may have a significant adverse impact on the Company's financial performance.

To mitigate the risk from such changes the Company works closely with both government and railway groups.

(b) Economic outlook

The downturn in the UK economy has affected travel patterns resulting in lower than expected passenger numbers. This trend may continue for some time to come. Procedures are in place to mitigate this risk through the use of market research activities, weekly revenue reports and analysis, and innovative marketing campaigns.

(c) Terrorism

Terrorist incidents or a terrorist campaign (direct or an attack on other public transport) could adversely impact operations and passenger demand. The Group has a security programme in place which meets TRANSEC requirements and the Group attends ATOC Emergency Planning Meetings. The Group also has a rigorous, ongoing training and inspection regime in place.

(d) Key personnel

The retention and recruitment of key personnel is essential to ensure that the Group has the correct level of expertise and industry knowledge. Plans to facilitate the retention of key staff during a future transition period are underway.

Financial risk management

The Company's activities expose it to a variety of financial risks. Price risk is managed by the Company having fixed prices where possible which are set annually and are subject to regulatory approval. Credit risk is managed by cash being held by large high street financial institutions with satisfactory credit ratings, furthermore all significant receivable balances are managed to ensure that the credit quality of the counterparty is satisfactory. Liquidity risk is controlled by the Company ensuring that there is a sufficient mixture of long-term and short-term debt finance to meet planned operations. Cash flow risk is managed by cash flow budgeting and forecasting and availability of long term debt facilities if required.

Directly Operated Railways Limited

Annual Report and Financial Statements

Directors' Report

Statement of Directors' Responsibilities

The Directors are responsible for preparing the 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 Group and parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing these financial statements, the Directors are required to

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

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

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

Auditors

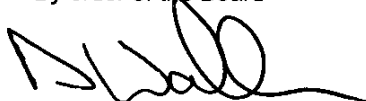
In accordance with Section 487 of the Companies Act 2006, the auditors shall be deemed to be re-appointed as the Company's auditors 28 days after the financial statements are sent to members.

Directors' statement as to disclosure of information to auditor

Each Director who held office at the date of approval of the Directors' Report confirms 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.

By order of the Board



David Walker
Finance Director
21 June 2012

Registered Office 4th Floor, One Kemble Street, London, WC2B 4AN

**Directly Operated Railways Limited
Annual Report and Financial Statements
Independent Auditors' Report to the members of
Directly Operated Railways Limited**

We have audited the Group and Parent Company financial statements of Directly Operated Railways Limited for the year ended 31 March 2012 which comprise of the Consolidated Profit and Loss Account, the Statement of Total Recognised Gains and Losses, the Consolidated and Company Balance Sheets, the Consolidated Cash Flow and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Respective responsibilities of Directors and Auditors

As explained more fully in the Statement of Directors' responsibilities set out on page 16 the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the Group's and Parent Company's affairs as at 31 March 2012 and of the Group's profit and cash flows for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006

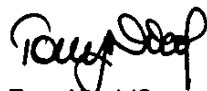
Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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



Tony Nicol (Senior Statutory Auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
21 June 2012

Directly Operated Railways Limited
Annual Report and Financial Statements
Consolidated Profit and Loss Account
For the year ended 31 March 2012

	Note	2012 £'000	2011 £'000
Turnover	2		
Passenger income		594,788	578,387
Other operating income		<u>71,099</u>	<u>67,086</u>
Total turnover		665,887	645,473
Operating expenditure		<u>(661,031)</u>	<u>(641,299)</u>
Operating profit		4,856	4,174
Interest receivable and similar charges	6	424	369
Interest payable and similar charges	6	(907)	(1,140)
Other finance income	20	<u>2,738</u>	<u>3,129</u>
Profit on ordinary activities before taxation		7,111	6,532
Taxation on profit on ordinary activities	7	<u>(2,130)</u>	<u>(2,474)</u>
Profit for the financial year		<u>4,981</u>	<u>4,058</u>

The profit and loss account has been prepared on the basis that all operations are continuing operations

There are no material differences between the profit on ordinary activities before taxation and the profit for the financial years stated above and their historical cost equivalents

Directly Operated Railways Limited
Annual Report and Financial Statements
Statement of Total Recognised Gains and Losses
For the year ended 31 March 2012

	2012	2011
	£'000	£'000
Profit for the financial year	4,981	4,058
Actuarial loss on defined benefit pension scheme	(759)	(3,829)
Movement on deferred tax relating to defined benefit pension scheme	197	995
Total recognised gains and losses relating to the year	<u>4,419</u>	<u>1,224</u>

Directly Operated Railways Limited
Annual Report and Financial Statements
Consolidated Balance Sheet
As at 31 March 2012

	Note	2012 £'000	2011 £'000
Fixed assets			
Tangible assets	8	17,407	7,769
Investments	9	-	-
		<u>17,407</u>	<u>7,769</u>
Current assets			
Stock	10	4,757	4,453
Debtors	11	65,319	73,647
Cash at bank and in hand		24,652	61,049
		<u>94,728</u>	<u>139,149</u>
Creditors' amounts falling due within one year	12	<u>(101,915)</u>	<u>(139,165)</u>
Net current liabilities		<u>(7,187)</u>	<u>(16)</u>
Total assets less current liabilities		10,220	7,753
Creditors' amounts falling due after more than one year	13	(988)	(1,576)
Provisions for liabilities	14	<u>(542)</u>	<u>(372)</u>
Net assets excluding net pension liability		8,690	5,805
Net pension liability	20	<u>(1,725)</u>	<u>(3,259)</u>
Net assets including net pension liabilities		<u>6,965</u>	<u>2,546</u>
Capital and reserves			
Called up share capital	16	-	-
Profit and loss account	17	6,965	2,546
Total shareholders' funds	17	<u>6,965</u>	<u>2,546</u>



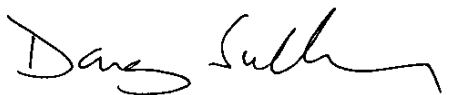
Doug Sutherland
Chairman
21 June 2012

Company number 06950819

The notes on pages 23 to 36 form an integral part of these financial statements

Directly Operated Railways Limited
Annual Report and Financial Statements
Company Balance Sheet
As at 31 March 2012

	Note	2012 £'000	2011 £'000
Fixed assets			
Investments	9	-	-
		<u>-</u>	<u>-</u>
Current assets			
Debtors	11	299	793
Cash at bank and in hand		<u>10,635</u>	<u>21,130</u>
		10,934	21,923
Creditors amounts falling due within one year	12	<u>(12,819)</u>	<u>(23,017)</u>
Net current liabilities		<u>(1,885)</u>	<u>(1,094)</u>
Total assets less current liabilities		<u>(1,885)</u>	<u>(1,094)</u>
Net liabilities		<u>(1,885)</u>	<u>(1,094)</u>
Capital and reserves			
Called up share capital	16	-	-
Profit and loss account	17	<u>(1,885)</u>	<u>(1,094)</u>
Total shareholders' deficit	17	<u>(1,885)</u>	<u>(1,094)</u>



Doug Sutherland
Chairman
21 June 2012

Company number 06950819

The notes on pages 23 to 36 form an integral part of these financial statements

Directly Operated Railways Limited
Annual Report and Financial Statements
Consolidated Cash Flow Statement
For the year ended 31 March 2012

		2012 £'000	2011 £'000
	Note		
Net cash (outflow)/inflow from operating activities	21	(7,924)	21,371
Returns on investments and servicing of finance			
Interest received		174	272
Interest paid		<u>(32)</u>	<u>(225)</u>
Net cash inflow from returns on investment and servicing of finance		<u>142</u>	<u>47</u>
Taxes paid		-	(4,759)
Capital expenditure and financial investment			
Fixed asset purchases		(13,096)	(3,945)
Net cash outflow from capital expenditure and financial investment		<u>(13,096)</u>	<u>(3,945)</u>
Financing			
Loan from parent organisation		-	10,000
Repayment of loans		<u>(15,518)</u>	<u>(7,285)</u>
Net cash (outflow)/inflow from financing		<u>(15,518)</u>	<u>2,715</u>
(Decrease)/increase in cash at bank and in hand		<u>(36,397)</u>	<u>15,429</u>
Net cash at 1 April		<u>61,049</u>	<u>45,620</u>
Net cash at 31 March		<u>24,652</u>	<u>61,049</u>

**Directly Operated Railways Limited
Annual Report and Financial Statements
Notes to the Financial Statements
For the year ended 31 March 2012**

1 Accounting policies

a) Fundamental accounting concept

The financial statements have been prepared on a going concern basis. The Directors have reviewed the subsequent trading results and the forecasts for future trading. The Company is expected to trade profitably for the foreseeable future and to be able to meet all its liabilities as they fall due. Consequently, the Directors believe that it is appropriate to prepare these financial statements on a going concern basis.

b) Basis of preparation

The financial statements are prepared under the historical cost convention and in accordance with the Companies Act 2006 and applicable accounting standards in the United Kingdom. The principal accounting policies which have been applied consistently are set out below.

At the balance sheet date, the Company has net liabilities. The ultimate shareholder, the Secretary of State for Transport, has confirmed that the Company will continue to be supported for at least twelve months from the date of signing these financial statements. Accordingly, the Directors are satisfied that the going concern basis remains appropriate for the preparation of these financial statements.

c) Turnover

- (i) Passenger income represents amounts agreed as attributed to the Company by the income allocation systems of the Rail Settlement Plan Limited, mainly in respect of passenger receipts. Income is attributed based principally on models of certain aspects of passengers' travel patterns and, to a lesser extent, from allocations agreed for specific revenue flows. The attributed share of season ticket income is deferred within creditors, and released to the profit and loss account over the period of the relevant season ticket.
- (ii) Other income is derived from ticket commissions, station trading income, depot and station access payments, performance regime payments, and the provision of goods or services to other train operating companies and the Department for Transport and excludes VAT. Revenue is recognised upon completion of services or delivery of goods. Revenue from services is recognised on the basis of agreed rates. Commission income is recognised on an accrual basis in accordance with the substance of the relevant agreements.
- (iii) The Company operates a loyalty programme which operates through the East Coast Mainline web site and is open to all passengers who book tickets on line. The scheme allows travellers to accumulate points that entitle them to a choice of various awards, primarily free travel. The fair value attributed to the awarded points is deferred as a liability and recognised as revenue on redemption of the points by the participants to whom they are issued to.

d) Taxation

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to taxation authorities using the tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

e) Deferred tax

Deferred tax is recognised in respect of all material timing differences that have originated, but not reversed, by the balance sheet date. Deferred tax is measured on a non-discounted basis at tax rates that are expected to apply in the periods in which the timing differences reverse.

Deferred tax assets are recognised where their recovery is considered more likely than not in that there will be suitable taxable profits from which the future reversal of underlying timing differences can be deducted.

Directly Operated Railways Limited
Annual Report and Financial Statements
Notes to the Financial Statements
For the year ended 31 March 2012

f) Tangible fixed assets and depreciation

Tangible fixed assets are stated at historic cost less accumulated depreciation. Depreciation is provided on a straight line basis to write off the cost less estimated residual value of fixed assets over their expected useful economic lives as follows -

Leasehold land & buildings	3 – 10 years or lease term
Plant and equipment	3 – 10 years or lease term

g) Leased assets

Assets held under finance leases are included as tangible fixed assets and depreciated over their expected useful lives. The corresponding obligations relating to finance leases, excluding finance charges allocated to future periods, are included in creditors. Finance costs are allocated to the profit and loss account over the period of the lease in accordance with the interest rate inherent in the lease.

Operating lease rentals are charged to the profit and loss account on a straight-line basis over the lease term.

h) Stocks

Stock is valued at the lower of cost and net realisable value on a weighted average cost basis. Cost comprises direct costs and excludes borrowing costs. Net realisable value is the estimated replacement value of stock. Where necessary, provision is made for obsolete, slow moving and defective stocks.

i) Grants

Capital grants are credited to deferred grant income and released to the profit and loss account over the estimated useful economic lives of the related assets.

j) Retirement benefits

The Company contributes to a defined benefit pension scheme on behalf of the majority of employees. Full details are provided in note 20.

The Company participates in the Railway Pension Scheme ("RPS"), a defined benefit scheme which covers the whole of the UK Rail industry. This is partitioned into sections and the Company is responsible for the funding of the sections whilst it operates the relevant franchise. In contrast to the pension schemes operated by most businesses, the RPS is a shared cost scheme, which means that costs are formally shared 60% employer and 40% employee.

The trustees complete a full actuarial valuation triennially, separately for each section of the RPS, but the obligation is updated annually by independent actuaries using the projected unit credit method for financial reporting purposes.

The current service cost and gains and losses on settlements and curtailments are recognised in staff pension costs within operating costs in the profit and loss account. Past service costs are included in operating costs where the benefits have vested, otherwise they are amortised on a straight-line basis over the vesting period. The expected return on assets of funded defined benefit schemes and the interest on pension scheme liabilities comprise the finance element of the pension cost and are included in interest costs. Actuarial gains and losses arising from experience adjustments, changes in actuarial assumptions and amendments to pension plans are charged or credited to the statement of total recognised gains and losses in the period in which they arise.

The charges in respect of defined contribution schemes are recognised when they are due. The Company has no legal or constructive obligation to pay further contributions into a defined contribution scheme if the fund has insufficient assets to pay all employees' benefits relating to employee service in the current and prior periods.

Directly Operated Railways Limited
Annual Report and Financial Statements
Notes to the Financial Statements
For the year ended 31 March 2012

k) Provisions

Provisions for current obligations and legal claims are recognised when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated. Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognised for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

l) Fixed asset investments

Fixed asset investments are initially recognised at cost and thereafter are carried in the balance sheet at cost less any impairment in value. All the fixed asset investments are subject to an impairment review at any time if events or changes in circumstances indicate that their carrying value may not be recoverable.

2 Turnover

All turnover originates in the United Kingdom.

The Directors consider that the whole of the activities of the Company constitute a single class of business consisting of passenger and other related operating income as disclosed in the Profit and Loss Account.

3 Operating profit

	2012	2011
	£'000	£'000
Operating profit is stated after charging		
Staff costs (note 5)	114,796	115,028
Depreciation – owned assets	3,454	2,161
Impairment charge	-	7,800
Amortisation of goodwill	-	(2,278)
Amortisation of fixed asset grants	(135)	(185)
Operating lease rentals		
– Fixed track access	45,258	43,524
– Land and buildings	6,450	5,597
– Rolling stock costs	82,277	83,132
– Plant and machinery	2,116	2,034
– Other	4,553	4,844
Auditors' remuneration – audit fees	80	82
Auditors' remuneration – (non audit services)		
– taxation compliance	22	11
– other compliance reporting	10	6

Directly Operated Railways Limited
Annual Report and Financial Statements
Notes to the Financial Statements
For the year ended 31 March 2012

4. Directors' emoluments

	2012 £'000	2011 £'000
Aggregate emoluments in respect of qualifying services to the Company	490	377
Company contributions made to money purchase pension schemes	33	44
Total	<u>523</u>	<u>421</u>

The emoluments excluding pension contributions of the highest paid Director were £175,125 (Year ended 31 March 2011 £192,500)

The pension contributions of the highest paid Director were £32,805 (Year ended 31 March 2011 £43,700)

5. Staff costs

	2012 £'000	2011 £'000
Wages and salaries	95,725	94,680
Social security costs	7,867	6,752
Pension costs	8,865	10,934
Other costs	2,339	2,662
	<u>114,796</u>	<u>115,028</u>

The average number of employees (including Directors) during the period was as follows

	2012	2011
Managerial and administrative	457	455
Operational	2,334	2,276
	<u>2,791</u>	<u>2,731</u>

6. Interest receivable and similar income / Interest payable and similar charges

	2012 £'000	2011 £'000
Interest receivable		
Bank interest	424	123
Other interest receivable	-	246
	<u>424</u>	<u>369</u>
Interest payable		
Bank interest	31	81
Interest payable to group undertakings	862	1,059
Other interest payable	14	-
	<u>907</u>	<u>1,140</u>

Directly Operated Railways Limited
Annual Report and Financial Statements
Notes to the Financial Statements
For the year ended 31 March 2012

7 Tax on profit on ordinary activities

(a) The tax charge on the profit on ordinary activities before taxation is made up as follows

	2012 £'000	2011 £'000
Current taxation		
UK corporation tax on profits of the year	886	1,199
Adjustment in respect of previous years	597	1,306
	1,483	2,505
Deferred taxation		
Origination and reversal of timing differences (note 15)	45	(56)
Defined benefit pension	602	25
	647	(31)
Tax charge on profit on ordinary activities	2,130	2,474

(b) The tax for the year is lower (2011 higher) than the standard effective rate of corporation tax in the UK of 26% (2011 28%). The current tax charge is made up as follows

	2012 £'000	2011 £'000
Profit on ordinary activities before taxation	7,111	6,532
Notional charge at UK corporation tax rate of 26% (2011 28%)	1,849	1,829
Not deductible expenses	405	(2,168)
Income not subject to tax	(3)	-
Capital allowances (in excess of)/lower than depreciation	(71)	433
Amortisation of goodwill not deductible	-	1,546
Other short-term timing differences	(1,294)	(441)
Adjustment in respect of previous years	597	1,306
Current tax charge for the year	1,483	2,505

During the year, as a result of the change in the UK main corporation tax rate from 26% to 24% that is effective from 1 April 2012, the relevant deferred tax balances have been re-measured

In addition to the changes in rates of corporation tax disclosed above a number of further changes to the UK corporation tax system were announced in the March 2012 UK budget statement. Legislation to reduce the main rate of corporation tax from 24% to 23% from 1 April 2013 is expected to be included in the Finance Act 2012. Further reductions to the main rate are proposed to reduce the rate to 22% from 1 April 2014. These further changes had not been substantively enacted at the balance sheet date and therefore are not included in these financial statements. The proposed reduction of the main rate of corporation tax to 22% from 1 April 2014 is expected to be enacted separately.

Directly Operated Railways Limited
Annual Report and Financial Statements
Notes to the Financial Statements
For the year ended 31 March 2012

8. Tangible fixed assets

	Leasehold Land & Buildings	Plant and Equipment	Total
	£'000	£'000	£'000
Cost			
At 1 April 2011	2,898	7,726	10,624
Additions at cost	3,345	9,751	13,096
Disposals	-	(245)	(245)
At 31 March 2012	6,243	17,232	23,475
Accumulated depreciation			
At 1 April 2011	702	2,153	2,855
Charge for the year	685	2,769	3,454
Disposals	-	(241)	(241)
At 31 March 2012	1,387	4,681	6,068
Net book amount at 31 March 2012	4,856	12,551	17,407
Net book amount at 31 March 2011	2,196	5,573	7,769

There were no assets held under finance leases at the year end

9. Fixed asset investments

The Group held the following unlisted investments at 31 March 2012

	Country of registration	No of shares held	Class of share	Proportion held
ATOC Limited	UK	1	Ordinary (4p)	5%
Rail Settlement Plan Limited	UK	1	Ordinary (4p)	5%
Rail Staff Travel Limited	UK	1	Ordinary (4p)	5%
NRES Limited	UK	1	Ordinary (£1)	5%

The principal activity of the above companies is to provide a range of services to all UK passenger rail operators, each of which has an equal share in the companies

The Directors believe that the carrying value of the investments is supported by their underlying net assets

The Company held the following unlisted investment at 31 March 2012

	Country of registration	No of shares held	Class of share	Proportion held
East Coast Main Line Company Limited	UK	1	Ordinary (£1)	100%

Directly Operated Railways Limited
Annual Report and Financial Statements
Notes to the Financial Statements
For the year ended 31 March 2012

10. Stocks

	Group		Company	
	2012	2011	2012	2011
	£'000	£'000	£'000	£'000
Raw materials and consumables	<u>4,757</u>	<u>4,453</u>	<u>-</u>	<u>-</u>

There is no material difference between the replacement value of stocks and its cost

11. Debtors

	Group		Company	
	2012	2011	2012	2011
	£'000	£'000	£'000	£'000
Trade debtors	46,261	49,160	-	-
Amounts owed by group undertakings	-	-	5	-
Deferred consideration	-	6,639	-	-
Corporation tax	531	1,826	286	393
Deferred tax	59	104	-	-
Other debtors	4,664	8,341	8	11
Prepayments and accrued income	13,804	7,577	-	389
	<u>65,319</u>	<u>73,647</u>	<u>299</u>	<u>793</u>

12 Creditors amounts falling due within one year

	Group		Company	
	2012	2011	2012	2011
	£'000	£'000	£'000	£'000
Bank loans	494	4,549	-	-
Trade creditors	64,733	70,487	-	4
Amounts owed to parent organisation	12,338	22,476	12,338	22,476
Deferred season ticket income	4,134	4,148	-	-
Social security and other taxation	2,332	2,158	9	19
Other creditors	3,192	11,428	8	-
Deferred fixed asset grants	93	135	-	-
Accruals and deferred income	14,599	23,784	464	518
	<u>101,915</u>	<u>139,165</u>	<u>12,819</u>	<u>23,017</u>

Included within the amounts owed to parent organisation is a loan balance outstanding at the balance sheet date of £10,000,000 (2011 £21,000,000) provided to the Company under a £40,000,000 working capital facility entered into on 9 November 2009 with the Secretary of State for Transport for the purpose of providing the Group with day to day working capital. This facility is a revolving credit arrangement provided on an unsecured basis and is repayable on demand. Interest is payable at LIBOR + 4.5%

Directly Operated Railways Limited
Annual Report and Financial Statements
Notes to the Financial Statements
For the year ended 31 March 2012

13. Creditors: amounts falling due after more than one year

	Group		Company	
	2012	2011	2012	2011
	£'000	£'000	£'000	£'000
Bank loans	988	1,483	-	-
Deferred fixed asset grants	-	93	-	-
	<u>988</u>	<u>1,576</u>	<u>-</u>	<u>-</u>

The bank loan is guaranteed by the Department for Transport. The rate of interest payable is LIBOR plus 0.25 per cent.

14. Provisions for liabilities

	Group		Company	
	2012	2011	2012	2011
	£'000	£'000	£'000	£'000
At 1 April	372	44	-	-
Provided in the year	170	328	-	-
At 31 March	<u>542</u>	<u>372</u>	<u>-</u>	<u>-</u>

15. Deferred tax

(a) The deferred tax at a rate of 24% (2011: 26%) excluding tax on the pension liability provision movement in the year is as follows:

	Group		Company	
	2012	2011	2012	2011
	£'000	£'000	£'000	£'000
Opening balance	104	48	-	22
Increase in the year	(45)	56	-	(22)
Closing balance	<u>59</u>	<u>104</u>	<u>-</u>	<u>-</u>

(b) The major components of the deferred taxation asset are as follows:

	Group		Company	
	2012	2011	2011	2011
	£'000	£'000	£'000	£'000
Other timing differences	4	30	-	-
Short term timing differences	55	74	-	-
	<u>59</u>	<u>104</u>	<u>-</u>	<u>-</u>

16. Called up share capital

	Group and Company	
	2012	2011
	£	£
<i>Authorised</i>		
Ordinary shares of £1 each	<u>100</u>	<u>100</u>
<i>Allotted, called up and fully paid</i>		
Ordinary shares of £1 each	<u>1</u>	<u>1</u>

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17 Reserves and reconciliation of movements in shareholders' funds/(deficit)

	Group		Company	
	2012	2011	2012	2011
	£'000	£'000	£'000	£'000
Shareholders' funds/(deficit) at 1 April	2,546	1,322	(1,094)	(44)
Actuarial loss on defined benefit pension scheme	(759)	(3,829)	-	-
Movement on deferred tax relating to defined benefit pension scheme	197	995	-	-
Profit/(loss) for the financial year	4,981	4,058	(791)	(1,050)
Shareholders' funds/(deficit) at 31 March	6,965	2,546	(1,885)	(1,094)

18. Capital commitments

	Group		Company	
	2012	2011	2012	2011
	£'000	£'000	£'000	£'000
Contracted	1,779	1,771	-	-
Authorised but not contracted	409	7,380	-	-

19 Operating lease commitments

The Group has the following annual commitments due under non-cancellable operating leases which expire as follows

	2012			2011		
	Under 1 year	1 – 5 years	5 years and over	Under 1 year	1 – 5 years	5 years and over
	£'000	£'000	£'000	£'000	£'000	£'000
Fixed track access	-	48,839	-	-	45,262	-
Rolling stock	-	82,658	-	-	85,619	-
Land and buildings	3,126	924	244	83	5,556	170
Plant and machinery	968	533	-	18	2,093	-
Other	1,806	-	-	-	4,816	-
	5,900	132,954	244	101	143,346	170

The Group has contracts with Network Rail Infrastructure Limited for access to the railway infrastructure (track, stations and depots)

The Company has no annual commitment due under operating leases

20 Retirement benefits

The Company's subsidiary, East Coast, operates a final salary pension scheme and is part of the Railways Pension Scheme. The assets and liabilities are identified separately from the remainder of the Scheme.

The section is a shared cost arrangement whereby the Company is only responsible for a share of the cost. The scheme is a shared cost section because any surplus or deficit is met in the ratio of 60%/40% by the employer and employees respectively.

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20 Retirement benefits (continued)

The figures reported below therefore represent only the Company's share of the cost, except that the tables reconciling the section liabilities and assets from the start to the end of the year are presented before the deduction of the members' share of the defined benefit cost, or the surplus or deficit. This is for simplicity of presentation and for consistency with the liabilities and assets quoted in the table showing the pension scheme liability or asset at the end of the year.

Employer contributions for the year ending 31 March 2012 are 15.84% (2011: 15.84%) of section pay. This rate will continue until 30 June 2012 when the employer contribution rate will change to a maximum of 60% of the long-term joint contribution rate of 29.75% of section pay. This rate is effective from 1st July 2012 and will apply until 30th June 2027.

The section is open to new members.

An actuarial valuation of the East Coast Main Line pension scheme using the projected unit basis, was carried out at 31 March 2012 by Towers Watson, independent consulting actuary. The major assumptions determined by the Company were:

Summary of assumptions

	31 March 2012 % pa	31 March 2011 % pa
Discount rate	5.1	5.6
Price inflation (RPI measure)	3.2	3.6
Increases to deferred pensions (2011: CPI measure)	2.2	2.6
Pension increases (2011: CPI measure)	2.2	2.6
Salary increases	3.7	4.1
Expected return on section assets	6.7	7.5

The assets in the scheme and expected rates of return were:

	Long-term rate of return expected on 31 March 2012 % pa	Value at 31 March 2012 £'000	Long-term rate of return expected on 31 March 2011 % pa	Value at 31 March 2011 £'000
Equities	7.1	243,553	7.8	237,459
Government bonds	3.1	14,341	4.4	15,467
Non-government bonds	4.6	14,703	5.5	13,851
Property	6.7	13,188	7.5	12,348
Other assets	2.5	4,116	3.8	469
Total asset value	6.7	289,901	7.5	279,594

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20 Retirement benefits (continued)

The assumed average expectation of life in years at age 65 is as follows:

		31 March 2012	31 March 2011
Male currently age 65	Pension under £9,000* pa or pensionable pay under £35,000**		
	pa	20.5	19.8
	Others	22.6	21.5
Male currently age 45	Pension under £9,300* pa or pensionable pay under £35,000**		
	pa	22.8	22.2
	Others	24.9	23.7
Female currently age 65	Pension under £9,300*** pa or pensionable pay under £35,000**		
	pa	22.4	21.7
	Others	24.8	22.7
Female currently age 45	Pension under £9,300*** pa or pensionable pay under £35,000**		
	pa	24.9	23.2
	Others	27.1	24.2

2011 life expectancy figures * under £8,500, ** under £30,000, *** under £3,000

Reconciliation of present value of scheme liabilities

	Year ended 31 March 2012 £'000	Year ended 31 March 2011 £'000
Opening section liabilities	344,838	384,093
Service cost	15,372	17,805
Interest cost	19,953	21,872
Interest on short term adjustment	(1,946)	(4,300)
Loss/(gain) on section liabilities	6,681	(66,802)
Actual benefit payments	(7,181)	(7,830)
Closing section liabilities	377,717	344,838

Pension scheme liability at end of year

	Year ended 31 March 2012 £'000	Year ended 31 March 2011 £'000
Total asset value	289,901	279,594
Present value of scheme liabilities	(377,717)	(344,838)
Total deficit	(87,816)	(65,244)
Members' share of deficit	35,126	26,098
Deficit expected to be recovered after the end of East Coast's involvement with the section	50,422	34,742
Pension scheme deficit attributable to the employer before deferred tax	(2,268)	(4,404)
Deferred tax	544	1,145
Pension scheme deficit attributable to the employer after deferred tax	(1,725)	(3,259)

The total scheme deficit of £87.8m is shared between the members and the franchise owner. As East Coast is only expected to operate the franchise until December 2013, only this proportion of the pension scheme deficit has been recognised, with the remainder taken by the members of the scheme and the future operators of the franchise.

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20 Retirement benefits (continued)

Reconciliation of pension scheme liability

	Year ended 31 March 2012 £'000	Year ended 31 March 2011 £'000
Opening pension scheme liability	(4,404)	(1,247)
Employer's share of pension cost	(6,733)	(7,805)
Employer contributions	9,628	8,477
Total gain/(loss) recognised in STRGL	(759)	(3,829)
Closing pension scheme liability	(2,268)	(4,404)

Sensitivity analysis of scheme liabilities

The sensitivity of the present value of scheme liabilities to changes in the principle assumptions used is set out below

	Change in assumption	Impact on scheme liabilities
Discount rate	Increase/ decrease by 0.1%	Increase/ decrease by 0.5%
Rate of inflation	Increase/ decrease by 0.1%	Increase/ decrease by 14.6%

The effect of changing the discount rate is small due to the offsetting impact of the short term adjustment for this section

The effect of changing the inflation rate is also small due to the offsetting impact of the short term adjustment for this section. The liability decreases rather than increases as would normally be expected because the deficit projected to 8 December 2013 is larger, resulting in a larger credit from the adjustment relating to East Coast's short term involvement in this operation

Reconciliation of fair value of scheme assets

	Year ended 31 March 2012 £'000	Year ended 31 March 2011 £'000
Opening value of section assets	279,594	251,702
Expected return on assets	21,274	19,920
(Loss)/gain on assets	(19,359)	2,116
Employer contributions	9,628	8,477
Employee contributions	5,945	5,209
Actual benefit payments	(7,181)	(7,830)
Closing value of section assets	289,901	279,594

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20 Retirement benefits (continued)

Analysis of the amount charged to profit or loss are as follows.

Disclosed pension cost

	Year ended 31 March 2012 £'000	Year ended 31 March 2011 £'000
Employer's share of service cost	9,471	10,934
Employer's share of interest cost	11,972	13,123
Interest on short term adjustment	(1,946)	(4,300)
Employer's share of expected return on assets	(12,764)	(11,952)
Employer's share of pension cost	6,733	7,805

Actuarial gains and losses

The cumulative amount of actuarial losses recognised in the statement of recognised gains and losses is £4,823,000 (2011 £4,064,000)

Defined contribution scheme

The cost of contributions to the defined contribution scheme amounts to £877,000 (2011 £861,000)

Historic information

	Year ended 31 March 2012 £'000	Year ended 31 March 2011 £'000	Period ended 31 March 2010 £'000	At 14 November 2009 £'000
Section liabilities	377,717	344,838	384,093	322,595
Assets	289,901	279,594	251,702	231,764
Deficit	(87,816)	(65,244)	(132,391)	(90,831)
Experience loss (liabilities)	(2,675)	7,526	6,862	n/a
Experience gain (assets)	11,615	(1,270)	(6,496)	n/a

21 Consolidated cash flow statement

(a) Reconciliation of operating profit to net cash inflow from operating activities

	2012 £'000	2011 £'000
Operating profit	4,856	4,174
Depreciation and amortisation	3,319	7,498
Difference between pension charge and cash contributions	(157)	2,457
(Decrease)/increase in stock and debtors	6,684	(11,351)
(Decrease)/increase in creditors and provisions	(22,626)	18,593
Net cash inflow from operating activities	(7,924)	21,371

(b) Reconciliation of net cash flow to movement in net funds

	2012 £'000	2011 £'000
(Decrease)/increase in cash in the year	(36,397)	15,429
Loan from parent organisation	11,000	(10,000)
Change in net cash resulting from cash flows	(25,397)	5,429
Net cash at 1 April	40,049	34,620
Net cash at 31 March	14,652	40,049

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21 Consolidated cash flow statement (continued)

(c) *Analysis of net funds*

	1 April 2011	Cash flow	Non Cash Movements	31 March 2012
	£'000	£'000	£'000	£'000
Cash at bank and in hand	61,049	(36,397)	-	24,652
Loan from parent organisation	(21,000)	11,000	-	(10,000)
Net cash in hand	40,049	(25,397)	-	14,652

22 Related party transactions

Directly Operated Railways Limited is a company wholly owned by the Secretary of State for Transport. In November 2009, the Company received direct funding by way of a loan under a £40,000,000 Working Capital Facility agreed with the Secretary of State for Transport. At the 31 March 2012, the Company had an outstanding balance of £12,338,000 (2011 £22,476,000) comprising £10,000,000 (2011 £21,000,000) loan balance and £2,338,000 (2011 £1,476,000) of accrued interest.

The Company's subsidiary, East Coast, operates for the east coast main line rail franchise under licence via a Services Agreement with the Department for Transport following the transfer of the business from National Express East Coast Limited on termination of their Franchise Agreement on 13 November 2009. Under the Services Agreement East Coast is required to pay a financial premium to the Department for Transport, which for the year to the 31 March 2012, amounted to £188,614,000 (2011 £176,279,000).

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

23. Ultimate parent undertakings

The ultimate parent undertaking and controlling party is the Secretary of State for Transport. The consolidated financial statements of the Secretary of State for Transport can be obtained from Great Minster House, 33 Horseferry Road, London, SW1 P4DR.