



***Delivering
a better railway
for a better Britain***

Network Rail Limited
Annual report and accounts 2014

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About us

We are the not for dividend owner and operator of Britain's railway infrastructure, which includes the tracks, signals, tunnels, bridges, viaducts, level crossings and stations – the largest of which we also manage. We aim to provide a safe, reliable and efficient rail infrastructure for freight and passenger trains.

Our highlights during the year

Our railway is more popular than ever, with passenger numbers increasing at a faster rate than expected. This alone has put a strain on our assets, and combined with the wettest winter for almost 250 years, has required increasing our efforts to deliver, particularly with regards to operational performance. Whilst we have failed to meet some of the targets set for CP4, our people have delivered some tangible results during the year – which we are proud to share.

→ **We exceed our level crossing closure target**

We closed 804 level crossings, exceeding our target of closing 750, 10 per cent of Britain's crossings, by April 2014. The closure of level crossings has been supported by a programme of other works including Rail Life – a national schools campaign and investment in technology.

→ **Extreme flooding in Dawlish**

Severe storms, torrential rainfall and strong winds in early 2014 disrupted our network, including 100 metres of sea wall destroyed in Devon. Our 300-strong 'orange army' battled for over two months to restore services so people could reach their destinations in Devon and Cornwall in time for Easter.

→ **Rail line at Hatfield and Stainforth reopens**

We completed one of the most complex recovery operations following a spoil heap slip at Hatfield Colliery. Engineers relocated approximately one million cubic metres of material and reinstated four tracks, including switches and crossings and associated signalling and power supplies.

→ **75 per cent of our CP5 contracts let**

We awarded contracts through which we will undertake 75 per cent of our £4.2bn infrastructure renewals and enhancements as part of our CP5 delivery plan. This will not only enhance the railway and meet future demand but will also support and generate economic growth across Britain.

→ **Promoting women in rail**

We continue to promote our entry-level programmes to women. We launched our 'Could IT be you?' competition, to inspire young women to consider a career in infrastructure technology and joined Women in Rail to provide mentoring support for women working in the rail industry.

→ **Record-breaking festive rail investment programme**

At more than £100m, we successfully completed the biggest ever investment programme over Christmas and New Year. Hundreds of our engineers and contractors worked the equivalent of more than 600,000 hours at over 100 locations across Britain.

→ **King's Cross Square opens**

The 75,000 sq ft King's Cross Square opened as the final part of the £550m redevelopment of King's Cross station.

→ **Plain line pattern recognition (PLPR)**

We deployed PLPR on the network. High definition, laser technology and thermal cameras were affixed to specialist trains, to find faults on the track, so we can now spend time fixing them, rather than having to find them in the first place.

Control periods are the five-year time periods which we receive funding for, and the outputs we must deliver, as agreed with the Government. Control Period 4 (CP4) ran from 1 April 2009 to 31 March 2014. Control Period 5 (CP5) runs from 1 April 2014 to 31 March 2019.

Cover images

1. Five new platforms at Reading station, a new footbridge and escalators, and lifts for step-free access to all platforms
2. Apprentices at our training centre in Gosport
3. Electrifying key rail routes across the North will mean faster, quieter and more comfortable journeys
4. The renovated Victorian structure at King's Cross station and the new 75,000 sq ft King's Cross Square
5. Following the winter storm damage our 'orange army' of workers celebrate the reopening of the Dawlish railway after two months of round-the-clock restoration work
6. Winter storms batter the sea wall at Dawlish

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Corporate governance

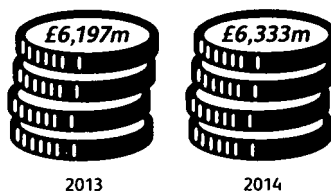
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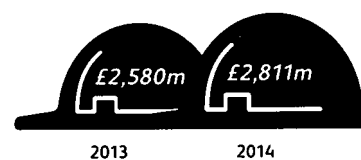
Our performance

In this report, we have outlined our performance during the year (the final year of CP4) and the challenges and plans we have for delivering a better railway for a better Britain over the next five years.



£6,333m

Revenue in the year
£6,197m in 2013



£2,811m

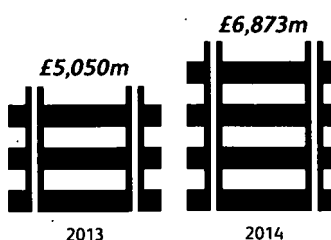
Operating costs
£2,580m in 2013

£1,256m

Profit after tax
£699m in 2013

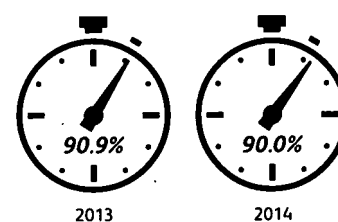
£33.0bn

Net debt
£30.4bn in 2013



£6,873m

Capital expenditure
£5,050m in 2013



90.0%

Passenger trains on time
90.9 per cent in 2013

What we do

We work with operators and supply chain partners on managing assets, timetables and investments for the benefit of passengers, freight users and tax payers. Our key businesses supporting this are – Asset Management, Network Operations, Infrastructure Projects and Property.

Asset Management

Our contribution to rail

The tracks, bridges, tunnels, embankments, signals and stations are the assets that make up the railway network.

We manage these in the smartest way we can by setting asset policies and providing assurance to the business around their whole-life management.

We also deliver long-term research, technology and innovation projects and provide essential asset information, telecoms and energy services to our business and external customers.

2014 in action

Network Operations

Our contribution to rail

We are responsible for the safe running of the railway every day, including timetabling, access, signalling, maintenance and local asset management.

The function is 'devolved' – split into routes which own and manage business relationships with our customers (the train and freight operators) and other external commercial stakeholders.

Being a devolved function enables us to work more closely with operators and deliver real improvements in safety, service, delivery and efficiency.

2014 in action

Latest technology

Our fleet of 26 tilting wagons have decks that can tilt around 60 degrees upwards. This means we can carry bulky pre-assembled parts of our infrastructure, such as switches and crossing units, or sections of track direct to site without dismantling them for travel so track is replaced quickly and efficiently with minimum disruption.

Cutting edge signalling centres

We are running longer, more frequent and faster passenger and freight trains than ever before, using the most advanced technologies and methods. Each signalling centre covers a large area with great precision and control to manage the network safely and efficiently.

12 state-of-the-art rail operating centres with advanced signalling tools and technology will eventually control large parts of the railway replacing more than 800 signal boxes and other operational locations helping reduce delays, improve performance and increase capacity.

Infrastructure Projects

Our contribution to rail

We are one of the largest delivery businesses in the country. We deliver infrastructure renewals and enhancements.

Our investment plan involves thousands of projects around the country aimed at delivering a bigger, better railway and enabling more trains to run at higher speeds with more seats and better facilities at stations up and down the country.

To support this delivery and enhance our aim of becoming more market competitive, the function is split into regions which are responsible for major renewal and enhancement infrastructure in their relevant areas.

2014 in action

Property

Our contribution to rail

We are the largest small business landlord in the UK with a national portfolio of over 7,400 properties.

Our activities create attractive and welcoming station environments, provide business space for companies to succeed and drive the sustainable regeneration of railway land.

We are constantly seeking new ways of generating income from our assets – with every extra pound of income generated going towards reducing the cost of the railway to the taxpayer.

2014 in action

Edinburgh to Glasgow Improvement Programme

Redeveloping Glasgow Queen Street, Scotland's third busiest station with 20 million passengers a year, is part of the Edinburgh to Glasgow Improvement Programme which will deliver a rolling programme of electrification across the Central Belt over the next five years and beyond. This programme will reduce journey times and boost capacity on key routes.

Bringing private investment to the railway

Solum Regeneration is a partnership between Network Rail and Kier Property formed to attract private investment to the railway. It drives value for the travelling public through station-led developments which generate funding for station and environmental improvements.

Solum has delivered projects at Epsom and Christchurch, is on site at Walthamstow and has further projects in the pipeline at Redhill and Haywards Heath.

Chairman's statement

Huge progress has been made on Britain's railway, but we have to remember that we are engaged in the first stages of a transformation that will take more than a decade to complete. With a century of underinvestment following the initial burst of dynamism and creativity of the Victorian pioneers, we should be under no illusion as to the long-term nature of the work in which we are engaged.

Inevitably, when one is engaged in a process of transformation that will be completed by generations to come, there will be slings and arrows along the way. With Network Rail so vital to the economic well-being of the nation it is no surprise there is such focus and scrutiny on how it is performing.

And, it would be fair to say, the board shares the view that performance over the year has been somewhat mixed.

In his review, later in this report, Mark Carne will talk in more detail about the safety of the public, passengers and our workforce. In many respects, our safety record compared to other railways around Europe is very good. Compared to other sectors, however, it is clear that there is still a great deal that can be done to improve.

Our vision, and the challenge we are accepting, is simple – everyone home safe, every day.

Another major cause for reflection in the past year has been train punctuality. Although the reasons why may be many and varied, there is no avoiding the fact that we did not meet the targets we were set, and agreed, in 2009. The challenge the board is setting the executive now is to get on top of this issue, and hit the targets for this control period. This will mean understanding why we missed those previous targets, and determining the best way to tackle those issues.

"The challenge the board is setting the executive now is to hit the targets for this control period."

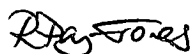
However, we recognise that, looked at in the round, the company has made great strides in the last five years. The capital programme has seen successes including the new King's Cross station, the reopened Airdrie-Bathgate line in Scotland, and the completion of the first phases of both the redevelopment of Reading station and the Thameslink Programme. In operational terms, we should not forget the substantial contribution Network Rail made to making London 2012 the first public transport Olympic Games. Alongside the improvements in passenger safety, the renewal of so much of our infrastructure and the delivery of substantial cost efficiencies, there is clearly much to celebrate.

There are many thousands of men and women at Network Rail who have contributed to those successes and, on behalf of the board, I would like to thank them for their hard work and endeavour.

We will continue to rely on those people as the company has committed to delivering a great deal more in the next five years in terms of performance, capacity, safety and efficiencies. Success will require us to look beyond our current ways of working. Innovation will be essential. New technology vital. Unless and until we can unlock their benefits we will continue to apply the same solutions to solve the problems we face, until such time as this becomes impossible. The next five years, if they are about anything at all, must be about how to harness innovation and technology in a systematic way to solve the problems we will face in the decades to come.

In September 2014, Network Rail's debt will officially be reclassified as public debt and the company as a public sector organisation. Although we believe the current model has much to recommend it, we recognise that a change in our most important relationships is inevitable, and we will be working as hard as possible to maintain the constructive nature of those relationships which have been so beneficial to date.

Finally, the departure of David Higgins in February 2014 was clearly a moment of huge significance for the company. I would like to thank David on behalf of the board for all he achieved at Network Rail, as I would other directors who stood down during the year. Mark Carne, David's successor has already made an impact and, with a strong team behind him, I know he will continue to build on past achievements so as to take us confidently into the future.



Richard Parry-Jones
Chairman

11 June 2014

"We should not forget the substantial contribution Network Rail made to making London 2012 the first public transport Olympic Games."

"Success will require us to look beyond our current ways of working. Innovation will be essential. New technology vital."

Above:
Handheld devices with bespoke applications log and record vital information, and replace the need to manually process paper-based records.

Chief executive's review

In my first few months as chief executive I have been privileged to meet many men and women who are as committed to what they do as anyone I have met throughout my career. This commitment and dedication has been inspiring. I feel proud to now be a part of the railway family; an industry that is central to the economic success of our country.

The railways are a long-term business, with many decisions having ramifications that can last for decades. But there is also a vitally important job to do each day.

Most importantly, we must get everyone home safe, every day. Today, we have a good passenger safety performance – among the best in Europe. And in the last five years there has been some genuine progress in reducing level crossing risk, as we have closed 804 crossings across Britain, a sustained programme of closure the like of which has never been seen before.

But there is more to do in both of these areas and we are committed to halving passenger risk and reducing level crossing risk by a quarter in the next five years.

Closing more level crossings is often challenged by local communities and we will need to engage ever more closely with them as we strive to reduce the potential impact of our railway on their lives.

In the area of workforce safety our performance does not benchmark well. I believe that workforce safety has to be a core value in the high-performing culture I want to build at Network Rail. Good safety performance and good business performance are not two competing priorities that need to be balanced in some way; they are one and the same

thing. We face many challenges, but we intend to meet those challenges with a workforce safety culture that will be a step change from where we are today.

As well as safety, our other main focus each day is getting trains to their destinations on time. Here, there is no getting away from the fact that Network Rail did not meet many of its targets, for the last year or the control period as a whole.

We know how important punctuality is to passengers and so these missed targets are a source of real dissatisfaction to us. Clearly, extreme weather has played its part, as have the levels of congestion we are now seeing on the network. But we also know that we need to do more to improve the reliability of our infrastructure. We are committed to working with train operating companies and others across the industry to better understand how we can improve railway reliability. We are putting in place robust plans to tackle these issues – and we are strengthening our performance management culture to hold ourselves accountable for delivery. A high-performing culture, with a focus on continuous structured improvement, will support and enable this.

Mention of the extreme weather brings to mind the most high profile issue of my first few months, the collapse of the sea wall at Dawlish. For all the problems this led to, it also caused me to reflect, when I attended the reopening with the Prime Minister just two months later, on what an amazing organisation Network Rail can be. A huge amount of creativity, skills, discipline and dedication was demonstrated across the country in dealing with the impact of the storms and flooding, but most visibly over those eight weeks in Devon. I want to harness that spirit, and apply it to all of the challenges we face over the next few years.

As we look to those challenges, we should acknowledge there is a great deal to build on. We are currently in the early stages of a programme of investment not seen on Britain's railways since the Victorian era. Just a few examples highlight what is being achieved. Consider the transformation of Reading, Haymarket, King's Cross, the removal of a major bottleneck on the East Coast Main Line at Hitchin and the reopening of the Airdrie to Bathgate railway in Scotland, transforming the opportunities of those who live in the communities along that line.

Similarly, we continue to increase capacity by enabling more trains to run – during the year we increased the number of services by a further 45,000 compared to the previous year. That is the equivalent of 130 extra trains every day, or many thousands of additional seats for passengers. Looking at the control period as a whole, we are now running 600,000 more services each year than we were five years ago, the equivalent of more than 1,700 additional services every day.

Equally, our financial performance, as Patrick Butcher will detail later in this report, continues to improve. We are reducing the cost of the railway and we will go further still in the next five years. This is vitally important to give confidence to governments as they determine the right balance between fares, subsidy and investment.

I believe we can approach the new control period with great confidence. We stand on the verge of a genuine transformation in our industry in the first half of this century, one built on the foundations already laid but now driven by new technology and a fresh approach to innovation. My focus will be to underpin this with a high-performing culture, where everyone is valued and able to deliver to the limit of their potential.

“We have closed 804 crossings across Britain, a sustained programme of closure the like of which has never been seen before.”

“We face many challenges, but we intend to meet those challenges with a workforce safety culture that will be a step change from where we are today.”

Chief executive's review continued

We will not achieve this transformation alone, of course. Our relationships with governments, the regulator, our customers, our suppliers, our employees and all stakeholders will be intrinsically linked to our success.

At Network Rail, we are clear we want to be a trusted leader in our industry, working effectively with others to deliver today and to plan for tomorrow. I look forward to working with you all in the months and years ahead.



Mark Carne
Chief executive

11 June 2014

"Looking at the control period as a whole, we are now running 600,000 more services each year than we were five years ago, the equivalent of more than 1,700 additional services every day."

Top left: Following the collapse of 100 metres of sea wall at Dawlish our engineers worked around the clock to restore the railway.

Middle left: Working to rebuild the railway at Botley in Hampshire following one of the worst landslips ever seen on the rail network.

Bottom left: Still taken from our current level crossing safety TV advertisement – 'See Track/Think Train'.

Top right: We are transforming London Bridge station, creating new platforms for more trains, building a new concourse, and creating a much bigger and better station.

Bottom right: The flyover at Hitchin opens up one of the main bottlenecks at Cambridge Junction and allows for more services, reduces delays and creates a link between the East Coast Main Line and Cambridge.

Our journey through CP4

CP4 was a challenging five years for us. It was a time when more passengers were choosing to travel by rail than at any time for 60 years. From Thameslink to the Olympics, devolution to iconic stations overhauls – we achieved a lot. Now as we embark on CP5, we will build upon our accomplishments.

Detail on how we performed throughout CP4 against our regulatory targets is at networkrail.co.uk/publications

2010

We publish our New Lines Study aiming to meet future demands for additional rail capacity for passengers and freight users.

We build a temporary railway in two days at Workington, reconnecting the two halves of the town that were cut off following flood damage to the foot and road bridges in the area.

We begin a partnership with the Samaritans to help reduce the number of people attempting to take their life on the railway, and the impact incidents have on railway staff.

2011

The Airdrie-Bathgate line opens, re-establishing a direct passenger link lost in the 1950s and increasing the range of options available for travel between Edinburgh and Glasgow.

As part of the regeneration of Newport, the station undergoes a £22m redevelopment – the largest station revamp in Wales. Engineers work around the clock to deliver a state of the art station – in time for the Ryder Cup.

First longer trains run on Thameslink following platform extensions, which target the most crowded services, providing 3,200 more seats at the busiest times of day.

2012

Regional decision-making largely devolves to route teams to deliver greater value for money and improve local stakeholder relationships.

We complete our 10-year programme of refurbishing and repainting the Forth Bridge – long considered one of the world's never-ending tasks – meaning the structure will not need fully repainting for at least 20 years.

King's Cross station Western concourse opens, improving the travelling experience for more than 45 million passengers who use it each year.

2013

London Olympics – more than five million people use rail for their journey to the events. We work with train companies to run extra services, longer trains and operate extended hours to provide 12.4 million extra seats.

We enter into a new alliance with South West Trains to deliver better rail services with a joint senior management team taking responsibility for trains and track on the route operating out of London Waterloo – a first for the UK rail industry.

The first of around 3,000 of our people move into the Quadrant:MK, our new national centre in Milton Keynes, putting the city at the heart of Britain's railway operations and helping cut millions of pounds a year from the cost of running the railway.

2014

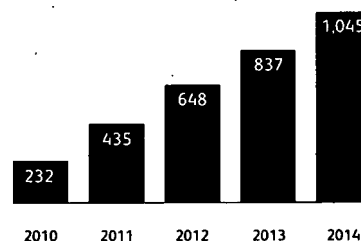
Our people work tirelessly to completely rebuild 80 metres of railway as extreme flooding in the South of England leads to a landslip at Botley, Hampshire.

New platforms and entrances open at Reading station as part of the redevelopment scheme, helping reduce congestion and improving passengers' experience.

We launch our safety vision – all our people have a requirement to work safely emphasising our belief that outstanding safety performance and outstanding business performance go hand in hand.

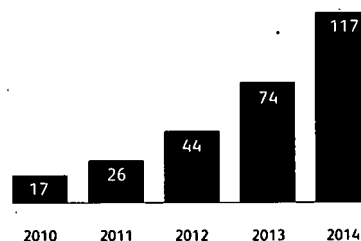
1,045

Individuals joined our award winning three-year apprenticeship scheme during CP4



117

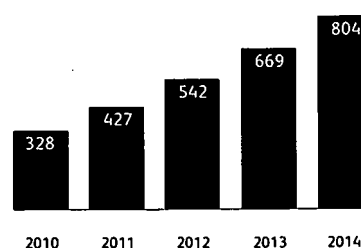
Projects under the 'Access for All'* programme completed during CP4



*The Department for Transport's Access for All programme is to improve accessibility at railway stations in Britain.

804

Level crossings closed during CP4



What we want to be

Becoming a trusted leader in our industry will require us to be customer-driven, accountable, challenging and collaborative.

Our vision

To be a trusted leader in the railway industry

We want to be a trusted leader in the rail industry.

Trust is the keyword: we want to be a trusted leader working in close collaboration with our partners. And we know that trust must be earned.

Our purpose

To generate outstanding value for taxpayers and customers

We do not pay dividends to shareholders. Instead, we reinvest our profits to improve the rail infrastructure.

As we rely on public funding and ticket revenues, we must always remain accountable to taxpayers and passengers.

Our role

Our role is to deliver a better railway for a better Britain

We will deliver a railway that is safer, more reliable, with greater capacity and efficiency, operating in a Britain that has a thriving, sustainable, low-carbon and balanced economy with better connections between people and jobs.

We recognise that we will only be able to do so through collaboration with the rest of the industry, and leading where appropriate.

We will achieve this by working with our partners and using our full potential to improve safety, reliability, capacity and value for customers and taxpayers.

We will do this by unlocking the potential and expertise of our people, and those who work for the passenger and freight operating companies, to take us to the next level of performance.

We have moved from the centralised, compliance driven mindset which was necessary in our first decade, to a more judgement-led, risk-based, locally responsive culture which can respond flexibly to the changed environment we now face.

Our behaviours

Being a trusted leader sets a new bar for what we do for our customers and their customers, how we do it and how we are perceived in the rail industry

Changing our behaviour is the only way we can achieve our vision and purpose.

We need to be customer-driven, accountable, challenging and collaborative:

Customer-driven

- We put safety at the heart of everything we do
- We provide exceptional service
- We deliver today and plan for tomorrow
- We listen and respond to our customers' needs.

Accountable, transparent and accessible

- We understand our priorities
- We use our knowledge and expertise
- We are confident making decisions
- We hold our hands up to mistakes.

Challenging, both of ourselves and each other

- We welcome different points of view
- We constantly seek better solutions
- We are confident in challenging others
- We welcome change.

Collaborative in the way we work with the rest of the rail industry

- We work openly and transparently
- We are respectful and trusting
- We are inclusive and welcoming
- We deliver results through others.

How we live our behaviours today

Being customer-driven

Passengers to benefit from high-speed mobile broadband on trains

In September 2013, Patrick McLoughlin, Secretary of State for Transport announced that high-speed mobile broadband will become available on the busiest parts of the rail network.

We consulted the rail industry, mobile network operators and the regulators to deliver a solution that will finally allow passengers to enjoy uninterrupted high-speed WiFi and voice and data services on-train and across the stations we manage.

Being accountable, transparent and accessible

Delivering results through our partnership with the Samaritans

We work with schools, communities and other agencies to help spread awareness of risk on the railway, as well as continuing our partnership with the Samaritans who have trained more than 5,000 railway staff to help those vulnerable people who may be considering taking their own life.

Being challenging

Seeking better solutions

"The renewals we carry out are rarely like-for-like. So we look at how we can innovate and replace life-expired assets with components that are better or more cost-efficient, or will fail less and require less maintenance. That's a big part of our remit – to push performance up, and get faults down."

J.P. Chesworth

Works delivery manager, signalling

Being collaborative

Working with our partners to drive change – Wessex Alliance

"The Alliance has made a real difference to the way we work; now there's just one joint station team all pulling together. We have shared objectives, decisions are made faster, and we're more efficient at what we do. It's not about doing things the 'South West Trains way' or the 'Network Rail way' – we're all focused on doing things the right way for our passengers."

M. Mackenzie

Manager, London Waterloo station

How we will get there: our operating environment

Our responsibility to safely transport people and goods to where they want to be, on time, every time is fundamental to Britain's economy.

To deliver our strategic themes (pages 16 to 20) we need to understand our external environment – focusing not only on the present but also on the future challenges.

Increasing growth

More and more people and goods are being transported by rail in Britain than ever before. It is anticipated that demand for rail will grow by more than 30 per cent over the next decade. Much of this demand will be driven by the continuation of economic and social trends – including population and employment growth and increasing road congestion.

Passenger demand

1.6 billion journeys are made each year and we carry 57 per cent more passengers than 10 years ago.

By 2019, the country's rail network will be delivering 225 million more passenger journeys every year. More trains will run between our Northern cities and 170,000 extra seats will be available going into our large cities nationwide.

Freight demand

Freight demand has increased significantly in recent years. Over the next decade we expect freight demand to grow by at least 30 per cent and as much as 140 per cent over the next 30 years.

Our challenge

Attracting more passengers and goods means that in many parts of the country demand outstrips supply – congestion makes it more and more difficult to meet our punctuality and efficiency targets and delivering the substantial improvements needed for the future.

High Speed 2 (HS2) and Network Rail – transforming Britain's railways

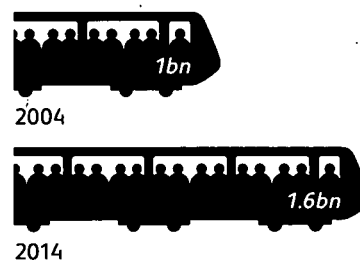
HS2 will sit at the heart of Britain's railways, connecting the major cities of the Midlands and the North with London. An integrated approach with HS2 will allow us to reshape the railway in a way that incremental improvements simply cannot.

We can deliver the biggest benefit for passengers, communities and freight if we plan for the high-speed and existing lines to operate seamlessly together. This will also enable us to build upon investments we are making today, such as the Northern Hub – our plan to stimulate economic growth in the North of England through better connections between key towns and cities.

We will be engaging with passengers and stakeholders, both inside and outside the industry, to seek their views on what work should be prioritised as we start to plan future services.

Passenger growth

Today we carry 57 per cent more passengers than 10 years ago



Freight demand growth

Over the next decade we expect freight demand to grow by at least 30 per cent and as much as 140 per cent over the next 30 years



Doing more for less


Rail users have made it clear that the railway must be more cost effective. While we do not set fares, fare revenue helps to fund everything we do.

Sustained investment

As agreed with the Government, we will spend £38bn over the next five years on running, maintaining and improving Britain's railway in order to meet continued demand for our services. Yet at the same time we will be trying to deliver more for less in the way we operate and run the railway on a daily basis.

Our challenge

We will need to change the way we work in order to bring about these efficiencies – the use of new technologies, smarter ways of working, alliances, partnerships with our key suppliers and working with our industry partners, will all contribute to delivering a more cost-effective railway.

 **betterrailway.co.uk** – outlines how we plan to deliver this sustained investment programme over the next five years.

The Rail Delivery Group (RDG) – a changing industry

We recognise that in order for us to maximise performance and deliver value for money we need to become better at working with the rail industry. The RDG brings together the leaders of the rail industry from the major train and freight operating companies and Network Rail.

The RDG provides a single and unified voice for the rail industry on key issues. The RDG leads the rail industry in developing rail strategies, policies and plans that will benefit passengers, freight shippers and taxpayers and identifies, pursues and facilitates the implementation of cross-industry efficiencies in areas such as asset management and technological innovation.

Our political and regulatory environment

Whilst our regulator – the Office of Rail Regulation (the ORR) – determines the income that we will receive from the Government and the outputs we must achieve, we operate as a commercial business.

From 1 September 2014, we will be reclassified as a central government body in the UK national accounts. This is as a result of changes in European accounting guidelines. A memorandum of understanding has been published by us and the Department for Transport, and we are working with the Government and ORR to explore consequential refinements to the current model and from what point these might be introduced.

Throughout the process, we are mindful that our job of delivering a safe, reliable and improving railway for four million daily users continues.

Our challenge

We are working to establish the future relationship between the company, the department and the regulator. We hope we will be able to agree a way forward that keeps the best of the current model, not least the ability for us to operate as a commercial business as far as is practicable. Nonetheless, we recognise that a change in our most important relationships is inevitable. To date, these relationships have overwhelmingly been immensely constructive, and we will be working as hard as possible to ensure that this remains the case.

How we will get there: our strategic themes

In 2013 we set out 10 themes central to our plans for a better railway. Against each of these we have made a commitment on which we want to be held to account. We believe we need to achieve our commitments over the next five years to deliver our vision.

Our vision sets out our intentions and aspirations at the highest level. Our themes set out what we believe we need to achieve to deliver our vision and be recognised as a leader in the development and operation of a safe, reliable and sustainable railway.

We are committed to monitoring and reporting on our progress annually so that stakeholders can hold us to account. The themes are cascaded into business unit and function scorecards. Together, these provide line of sight to employees. They also provide a framework and starting point for all employees when they set their individual performance objectives.

1 *Everyone home safe every day*

2 *Maintaining and building reliable infrastructure*

3 *Reliable timetables*

4 *The biggest investment programme since the Victorian era*

5 *A technology enabled future*

6 *A customer-focused organisation*

7 *Investing in our people*

8 *Opening up*

9 *A railway fit for the future*

10 *Reducing public subsidy*

Strategic theme	What we plan to do by 2019	What we have achieved so far
<p>1 Everyone home safe every day Keeping people safe on the railway is at the heart of everything we do. We're working to create a culture and system which will be sustainable for years to come and help us deliver not only a safer but a better performing and more efficient railway.</p>	<ul style="list-style-type: none"> • Reduce the risk at level crossings by 25 per cent as measured by the level crossing risk indicator model • Reduce train accident risk by 50 per cent • Eliminate all fatalities and major injuries among our workforce and the contractors who work for us. 	<ul style="list-style-type: none"> • We have deepened our understanding of the underlying factors that create train accident risk and identified what we can do to make a real difference. • For our people, we have introduced a confidential close call reporting line and life saving rules to help provide clear and simple instruction that our workforce can follow whilst also trusting them to use their own expertise and experience to manage risk in the workplace. • We introduced an electronic permit system to ensure better control of site safety and ensure that only staff employed on a permanent basis by contractors fill safety critical roles. <p>Find more about how we are addressing risk at level crossings and how we performed on safety in 2014 on pages 24 to 25.</p>
<p>2 Maintaining and building reliable infrastructure Managing our assets in the smartest way we can, making improvements and investing in infrastructure is how we will operate throughout CP5.</p>	<ul style="list-style-type: none"> • Become a benchmark against which organisations throughout the world assess their own asset management capabilities. 	<ul style="list-style-type: none"> • We are moving to a system of risk-based maintenance that allows us to monitor our assets, judge how well they are performing and then decide when to carry out maintenance work or renewals based on real-time, accurate data and judgements about criticality. • We have introduced a new long-term planning process. <p>Find more about this and how we performed in 2014 on page 33.</p>
<p>3 Reliable timetables We will aim to operate the best possible timetable every day on the available network.</p>	<ul style="list-style-type: none"> • Deliver for passengers and freight the best ever level of punctuality with a target of 92.5 per cent of trains arriving on time • Operate the best possible timetable every day on the network, and to be nearer our goal of operating a 'right time' timetable which uses GPS (global positioning system) equipment on trains to ensure the right train is at the right place at the right time. 	<ul style="list-style-type: none"> • We are working much more closely with the train operating companies on a daily basis, as well as with the Department for Transport to ensure that new franchises enable a more accurate timetable. <p>Find more about how Network Operations performed in 2014 on pages 34 to 35.</p>

How we will get there: our strategic themes continued

Strategic theme	What we plan to do by 2019	What we have achieved so far
<p>4 The biggest investment programme since the Victorian era We will deliver the biggest capacity increase on the railway for 100 years, benefiting people and businesses across Britain.</p>	<ul style="list-style-type: none"> • Deliver a step change in whole life, whole system capability through better project delivery • Deliver demonstrated value from working with our partners • Win business in competition. 	<ul style="list-style-type: none"> • We delivered over £5bn of infrastructure renewals and enhancements during the year. Our investment plan for the next five years involves thousands of projects around the country aimed at delivering a bigger, better railway and enabling more trains to run at higher speeds with more seats and better facilities at stations up and down the country. <p>Find more about how we performed in 2014 on page 36.</p>
<p>5 A technology enabled future We will use revolutionary data and equipment to help us transform maintenance methods.</p>	<ul style="list-style-type: none"> • Improved real time communication with our customers and other stakeholders • Begin implementation of the digitalised railway of the future that is compliant with European railway control systems • Implement a research and development programme which is integrated with our supply chain and supports investment in technology development. 	<ul style="list-style-type: none"> • We have introduced technology such as the Plain Line Pattern Recognition train which uses high-definition, laser technology and thermal cameras to find faults on the track so our staff can spend time fixing them, rather than having to find them in the first place. This means a more reliable track, and, therefore, a less disrupted service, as well as reducing the safety risk posed by our workforce being trackside. • We have secured regulatory funding and additional funding for technological innovations and investment.
<p>6 A customer-focused organisation We and our partners across the industry are working to deliver the best service for passengers.</p>	<ul style="list-style-type: none"> • Devolve decision-making closer to our customers and improve system operator capability • Potential creation of an infrastructure concession • Establish a transparent, joint risk and benefit sharing partnership model for each operator and/or route • Develop an integrated category-based supply chain. 	<ul style="list-style-type: none"> • We have worked with leaders in the industry through the Rail Delivery Group to focus on industry-wide issues • The creation of the South West Trains/ Network Rail alliance on the Wessex route, where the industry is working as a single business unit, has led to smarter and quicker decisions and a better service for customers.

Strategic theme	What we plan to do by 2019	What we have achieved so far
<p>7 Investing in our people We are developing the best asset we have in our effort to make a better railway for a better Britain – our people.</p>	<ul style="list-style-type: none"> • Implement a talent proposition and resourcing strategy • Embed succession planning and career management into the business units • Establish a more open, diverse and inclusive organisation. 	<ul style="list-style-type: none"> • We currently deliver 4.3 days of learning and development per employee, per year. We want to increase this to an average of five days, which would make us world class. • We continue our leadership development programme at Westwood in Warwickshire. • We are working collaboratively with our industry partners to organise joint training courses, and secondments to improve our collective understanding of how we can work better together. We are also playing an active part in trying to address the skills gap Britain faces in engineering disciplines by working with University Technical Colleges (UTCs) in Reading and Swindon to deliver rail-specific modules for students, as well as working as the lead employer with Westminster University, Transport for London and other organisations to develop a transport-based UTC for central London. <p>Find more about how we performed in 2014 on pages 46 to 47.</p>
<p>8 Opening up Our vision is to provide timely, relevant, accurate and consistent information – easily understandable and accessible wherever, whenever and however required – so that all passengers can make informed choices about their travel plans.</p>	<ul style="list-style-type: none"> • Establish an open and accessible organisation which understands, and helps others to understand, the issues shaping the future of the railway. 	<ul style="list-style-type: none"> • We regularly publish data and information on our website, as well as seeking views from other organisations and the public about what they would like us to publish. • We will act as if we are governed by the Freedom of Information Act 2000 from April 2015 • We are working closely with our train operator partners to see how we can improve information both before and during journeys. We plan to improve the consistency of information across stations. We are integrating the different systems we use into one which will feed into screens at stations, apps on smartphones and websites and on-train information.
<p>9 A railway fit for the future We are responding to the impact of climate change on the network and how we are embedding sustainability into our decision making to create value, preserve natural resources and respect the interests of our communities.</p>	<ul style="list-style-type: none"> • Implement our sustainable development strategy • Reduce the carbon intensity of our electricity supply by 14 per cent • Reduce our total carbon emissions • Invest in energy efficient assets • Include climate scenarios in our asset policies and investment decisions. 	<ul style="list-style-type: none"> • Severe weather has had a significant impact on the performance of the railway in CP4. We are working to better understand the impact not just of the recent battering, but of the extreme weather events over the past few years. We are working on a series of resilience studies and will identify further weather resilience plans for action in the coming months. <p>Find more about how we performed on energy efficiency in 2014 on pages 45 to 46.</p>

How we will get there: our strategic themes continued

Strategic theme	What we plan to do by 2019	What we have achieved so far
<p>10 Reducing public subsidy We have undertaken to deliver 20 per cent efficiencies from 2014 to 2019, while delivering a safe, reliable network and investing £38bn in a bigger, better railway.</p>	<ul style="list-style-type: none"> • Deliver CP5 outputs sustainably and efficiently • Develop the plan for our next control period (CP6) as part of longer term strategy for the network • Benchmarking with other railways demonstrating relative efficiency • Develop a sustainable funding and financing strategy • Develop mechanisms for raising third party capital. 	<ul style="list-style-type: none"> • Recent and planned rail investments – better stations, new trains and services, faster and more punctual journeys, and improved connectivity – will encourage more passengers to travel by rail. This growth is welcome as the extra revenue will help reduce the amount of subsidy needed by the industry, although further growth will also add to the industry's capacity challenge. • We delivered significant efficiencies this year and have undertaken to deliver 20 per cent efficiencies over the period to 2019. We will achieve these efficiencies through the use of new technologies, smarter ways of working and a revised contracting strategy. • We have developed our property and station retail portfolios, while seeking innovative new ways of generating income – like our 'Doddle' parcel collection concept at mainline stations – with every extra pound of income generated going towards reducing the subsidy. • We launched Network Rail Consulting, which is already winning overseas contracts. We hope that it will also act as a global ambassador for the British rail industry. • A significant number of rail franchises will be competitively re-tendered over the next decade, enabling train operators to continue to provide cost efficient rail services with a clear focus on revenue generation. We will also invest in the flexibility of the network – enabling train operators to deliver the timetable with fewer resources, saving the industry, and the taxpayer, money. • The rail industry is already developing its plans for CP6 through its Long Term Planning Process, which alongside identifying further investment choices for funders, maintains a clear focus on 'making better use'.

Our business model

Our business model is underpinned by our commitment to provide outstanding value for taxpayers and customers.

We operate as a regulated monopoly. The Government specifies what it needs from the railway and how much it will pay for it. Our regulator sets the level of charges we are allowed to pass on to train operators so that we provide value for money, maintain safe and reliable networks, and deliver good customer service.

How we generate revenue

While we are a commercial business, we are regulated by the Office of Rail Regulation (ORR). The ORR determines the income that we will receive from the Government and the outputs we must achieve over a five-year period (control periods).

Currently around two-thirds of our income comes direct from the UK Government. Principal sources of income are:

62%

Network grants from the Department for Transport (DfT) and Transport Scotland

62 per cent of our income for CP4 was in the form of network grant from the Government and is essentially fixed. Our grant income is reduced by rebates that we provide to the Government when we outperform our efficiency targets.

34%

Track access income from train operating companies (TOCs) and freight operating companies (FOCs)

15 per cent of our income comes from fixed track access charges to operators, leaving 19 per cent coming from variable charges to train operators. Our income from operators is reduced by compensation paid to operators under the performance regime.

4%

Income from commercial property

Four per cent of our income comes from our national property and station retail portfolio of over 7,400 properties.

How our revenue is determined

Our regulator assesses the efficient level of expenditure that we need to run our business and deliver the regulated outputs. It determines how much revenue we need, including an allowed return on our regulatory asset base (RAB) – its assessment of the value of our assets. This takes into account other income that we receive (such as commercial income from property). Net revenue is received from access charges and network grants. Our regulatory agreements then allow us to determine the amount we are allowed to charge train operators.

Our regulator calculates our revenue based on a number of building blocks:

Cost of service – our regulator considers what costs an efficiently run company would incur to operate and maintain our network for each year of the control period. They vary and can include, for example, costs relating to employees, office rental, IT systems and taxes. The regulator determines what is considered an efficient cost and this may be different to the actual costs we incur.

Expenditure on renewals and enhancements – our regulator assesses the capital expenditure on renewals and enhancements that we need to undertake in the control period. This expenditure is added to the RAB in the year in which it is incurred.

Allowed return – our regulator calculates the allowed return on the RAB and allows us to recover through access charges. This therefore covers, amongst 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.

Our business model continued

How we create shared value

Shared value

We believe it is important to deliver value for all our stakeholders. Our operations create value for our customers (freight and passenger operators) and

their customers, who make four million journeys a day; the communities we serve; and our 34,000 employees.

Our success benefits the economy, society and the environment. Through our robust business model, we are committed to delivering sustainable stakeholder value.

Licence to operate

We have a licence to operate as rail infrastructure owner and operator.

Providing a reliable rail network in a safe and efficient way is at the core of customer and stakeholder expectations.

We are committed to maintaining our licence through responsible behaviour.

Our approach and value creation

We manage, maintain and coordinate Britain's rail infrastructure. In doing so, our actions are value-adding to ensure we operate sustainably over the long term:

1. in the things we do – responsible stewardship:

- Operating the rail infrastructure day-to-day and maintaining a flexible and resilient timetable
- Maintaining the rail infrastructure day-to-day with a focus on whole life management
- Renewing and enhancing the rail infrastructure.

2. the way we do them – value approach:

- Everyone home safe every day
- Delivering through innovation
- Closer working with our customers
- Developing our people
- Being open and transparent
- Efficiency focused
- Environmentally sustainable.

To deliver tangible benefits

Responsible owner and operator

Over the past 11 years, we have strengthened our reputation as a reliable owner and operator. Being a responsible owner and operator means operating the railway and managing our assets in a safe and efficient way, reducing the impact of our operations on the environment and being customer focused.

Economic contribution

Public transport is vital to building a strong and sustainable UK economy. Our services ensure that millions of people are able to get to work and access key services and leisure activities. Both directly and indirectly, we make a significant contribution to the UK economy through the payments we make to our people and our suppliers.

We have delivered significant efficiencies over CP4. The money saved is helping to reduce public subsidies and sustain the biggest investment programme in decades.

Providing employment

We employ 34,000 people throughout the UK, providing jobs in a challenging economic environment and contributing directly to the Treasury. We invest in our people and believe providing opportunities for our employees to learn and develop makes for a stronger, more engaged and productive workforce.

Experienced and resourceful management with a local focus

Our devolved structure enables our locally based management teams to address customers' needs at a local level. These teams know their routes well and have the knowledge and experience to deliver high-quality services. This local focus is complemented by skills, expertise and support by central functions.

Supporting the community and economy

Our operations are at the heart of local communities. We operate in vibrant economic towns, cities and villages where there is strong demand for public transport. Our services enable people to access employment, education, retail and leisure facilities, supporting economic growth. Our local management teams work closely with local authorities to address the needs of these communities.

Open and transparent communication

Our regular and transparent engagement with stakeholders instils trust in our customers, employees and communities. The media value our willingness to communicate openly, and relationships with our suppliers benefit from transparent communication. Strong relationships with the Government and local authorities are key to our success. Our continual and open dialogue underpins these strong and long-standing relationships.

***Borders Railway bridge
construction completed***

The Borders Railway will re-establish passenger services between Edinburgh through Midlothian to Tweedbank in the Scottish Borders for the first time in over 40 years. The line includes 30 miles of new railway with 10 stops and seven new stations, offering a fast and efficient alternative to the congested road network.

Our approach to safety

We believe that outstanding safety performance and outstanding business performance go hand in hand.

Above: Full barrier level crossing.

Safety is at the core of everything we do, from our board to every colleague in every depot, station, signal box and office. Our safety vision is that everyone returns home safe every day. We do not underestimate the challenge of achieving this in a group which serves members of the public, including those who travel as passengers, with over 34,000 employees

working in eight routes, several businesses and a rail projects delivery business with a contractor workforce of up to 100,000.

Our vision has provided a common thread for all our work and communications around safety. It has also been adopted by many of our contractors. Our new chief executive, Mark Carne has emphasised the importance of our safety

vision and the role that each person has in its achievement. Our vision, the belief that safety and business performance go hand in hand, and our underpinning personal commitments have been rolled out from the executive committee across our organisation.

During the year, we started to implement our safety strategy which builds on our vision and provides a structured approach to improving the safety of passengers, the public and our workforce over the next decade.

We want to be a trusted leader in our industry, working with our partners and using our full potential to improve safety to safeguard passengers, the general public and our people.

What we plan to do by 2019

- Reduce the risk at level crossings by 25 per cent
- Reduce train accident risk by 50 per cent
- Eliminate all fatalities and major injuries among our workforce and the contractors who work for us.

How we performed during the year

Passenger safety

The passenger safety indicator at the end of the year was 0.194 against a year-end target of 0.240 (the lower the number the better) – significantly better than target and the same time last year. This is largely due to a reduction in passenger accidents at our managed stations.

This improvement has countered the increase in the passenger component of train accident risk for which we are the risk controller. We have deepened our understanding of the underlying factors that create this risk and are acting to address these factors. There were no passenger fatalities on our managed stations in the year. However, there were

54 major accidents in the year. Slips, trips and falls are the largest primary causes of accidents at managed stations.

We are focusing on activities at our managed stations to manage crowd flows and influence behaviour so that passenger injuries on our stations are reduced.

Workforce safety

The fatalities and weighted injuries rate was 0.161 against a year end target of 0.090 (the lower the measure the better) – compared with 0.149 in 2013.

There were three workforce fatalities in the year. There were a total of 122 major injuries in the year, compared with 104

in the previous year. Slips, trips and falls remain consistently the most common cases of accidents to contractor workforce.

This is an area which has received increased focus from our executive team during the year and the key initiatives under way to improve our performance on workforce safety can be found on page 25.

Public safety

During the year there were 18 adult accidental fatalities and no accidental child fatalities. In addition, there were 286 suicides. We continue to work closely with Samaritans to understand what more can be done to reduce suicide risk on the railway.

Level crossing risk

During the year, the risks associated with level crossings reduced by 10.49 per cent according to the level crossing risk indicator model. We therefore achieved a 31 per cent risk reduction in CP4, ahead of the 25 per cent risk reduction for the entire control period.

In our efforts to keep those using the railway safe, we closed 804 level crossings in the control period. With the help of

a £100m safety fund, we aim to reduce level crossing safety risk by a further 25 per cent through a combination of further level crossing closures and other risk reduction measures. We will focus our efforts on achieving the most cost-effective risk reduction, closing crossings where possible and ensuring the public understand the risks of unsafe use of crossings.

The key initiatives we have under way

We are working to develop an inclusive and mature safety culture by achieving a change in key behaviours across our organisation.

We are implementing a 10-point strategic plan to improve workforce safety. The plan provides a number of targeted interventions which will provide a sustainable step-change in the safety of the workforce and contribute towards our target of eliminating all workforce fatalities and major injuries. The components of the plan include: increasing clarity on roles and responsibilities when working trackside; investing in new technology to ensure our people remain safe when working trackside; how we treat people fairly; how we implement learning from incidents; our approach to planning our work; and the employment practices of our contractors to ensure that our plan is embedded in all their work practices.

We have implemented a number of positive safety culture interventions including:

- The introduction of the 11 lifesaving rules which cover the most fundamental safety issues
- The rollout of safety conversations training which has been delivered to our 400 most senior leaders. The training is intended to give leaders the skills to have open discussions on safety with staff at all levels
- Close call reporting: we collect all close call data in one location so we can track industry trends and patterns more efficiently and use this information to prevent accidents.

Safety

Our Vision **Everyone Home Safe Every Day**

Our Belief Outstanding safety performance and outstanding business performance go hand in hand.

Our Personal Commitments Safety is a core value and key to our success. Whether you are an employee, contractor or subcontractor, by delivering on our commitments we will achieve outstanding performance. This is how we will deliver a better railway for a better Britain.

Our safety vision

- Safe behaviour is a requirement of working for Network Rail.
- We will always comply with our Life Saving Rules.
- We will plan work to ensure that it can be done safely.
- Our work environments will be tidy – and we will leave them tidy when we've finished.
- We will ensure people have the skills and the equipment required to work safely.
- We will stop work if it cannot be done safely.
- We will personally intervene if we feel a situation or behaviour might be unsafe.
- We will use Close Calls to report unsafe behaviours and conditions.
- We will use our Fair Culture principles to investigate incidents and learn lessons to prevent them occurring again.
- We will relentlessly strive to find new ways to keep ourselves, colleagues, passengers and the public safe.
- We will design, construct, inspect, operate and maintain the railway to keep everyone safe.
- Safety leadership is key to how we assess our people's performance and readiness for progression.

Our approach to risk management

As with any business, we face a number of uncertainties in the course of our day-to-day operations. By effectively identifying and managing these risks, we are able to deliver our strategic themes.

Our approach to risk management

Our approach to risk management involves the identification of key risks to the achievement of each of our strategic themes through application of our Enterprise Risk Management (ERM) process. In addition we recognise our status as a regulated rail network infrastructure provider and the importance of maintaining essential service provision. The nature of our business is such that there are some significant inherent risks and these are outlined in the 'Principal Risks'.

The board's responsibility for risk management

The successful management of risks is essential to deliver our strategic themes. While the ultimate responsibility for risk management rests with the board, it delegates the more detailed oversight of risk management and internal control principally to the audit and risk committee which reports the findings of its reviews to the board. More detailed oversight of safety related risks is delegated to the safety, health and environment committee; operational performance risks to the policy and performance committee; treasury risk to the treasury committee. 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.

Our Enterprise Risk Management process

We continue to mature and embed our ERM process across the group. The ERM framework provides a standardised approach to the identification, assessment, recording and reporting of significant risks. We analyse the possible causes of a risk and assess what the impact could be if the risk were to occur. Using this process we are able to identify current controls and our present capacity to manage risk outcomes and consider further enhancement of controls to mitigate both likelihood and impact to help maximise our resilience to the identified risks.

Key risks are reported on quarterly to the audit and risk committee with the complete set of strategic risks reported in the form of a risk visual every six months. In addition, in-depth reviews are performed on individual risks and presented by the business owners to both the executive committee and respective oversight committee of the board.

Risk management in practice

Our assets across the country work 24 hours a day seven days a week to provide a safe, reliable rail network. With so many assets working with often extreme environmental pressures, occasionally things break down. We are committed to quick rectification of issues in order to maintain service provision. We have systems in place to monitor the performance of our assets and processes that alert us as soon as possible to potential problems. An example of this is the fleet of measurement trains monitoring track condition. The ERM process helps us to identify risks that arise over and above such day to day operational risks and in particular those that relate to our major strategic themes and major projects.

The board's responsibilities for the internal control system

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

The audit and risk committee, on behalf of the board, keeps the effectiveness of the system of internal control under review and has done so throughout the year.

Monitoring and reviewing internal controls

Our Internal Audit function provides independent assurance on the adequacy and effectiveness of the system of internal control.

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

In accordance with the Turnbull Guidance, an annual review of internal controls is conducted. The board has delegated authority to the audit and risk committee to monitor regularly internal controls and conduct the annual review. This review covers all material controls such as financial, operational and compliance, and also risk management systems in place throughout the year under review. No significant failings or weaknesses were identified from this review.

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

Our approach to risk management: **Safety**

Risk	Current actions	Planned
Failure to safeguard our workforce resulting in single and/or multiple fatalities to our staff (employees and contractors)	<ul style="list-style-type: none"> • We continuously monitor and assess safety risks through passenger, public and workforce metrics • Strong top down safety vision embedding 'Life-saving rules' and 'close call reporting' • Enhanced Sentinel permit to work programme to safeguard field workforce through competence management. 	<ul style="list-style-type: none"> • Transform our safety culture through CP5, with a view to eliminate all workforce fatalities and major injuries • Significant investment in key programmes such as: safety leadership and culture change programme, Business Critical Rules and 'Control of work system' to enhance the planning and implementation of safe systems of work.
Failure to adequately manage the railway infrastructure and prevent a major avoidable event e.g. collision, derailment etc	<ul style="list-style-type: none"> • Industry partner team setup to further understand signals passed at danger (SPAD) • Greater focus on improved safety measures integrated into asset design. 	<ul style="list-style-type: none"> • Strategy for 50 per cent reduction in train accident risk • Significant investment being made in risk based maintenance of our asset base throughout CP5.
Inadequate management of the interfaces between the public, passengers, trains and railway infrastructure leading to loss of life or major injury to the public	<ul style="list-style-type: none"> • 804 level crossings closed leading up to the end of CP4 with £131m invested through national level crossings risk reduction programme • National TV and advertising campaign combined with a multitude of tactical awareness campaigns. 	<ul style="list-style-type: none"> • Reduce level crossing safety risk by a further 25 per cent • Investment of >£100m across CP5 to improve safety and reduce risk to passengers and public.

Our approach to risk management: *Performance*






Risk	Current actions	Planned
<i>Failure to achieve passenger and train and freight operator capacity and performance expectations for the control period</i>	<ul style="list-style-type: none"> • Performance planning reform programme to address root cause of public performance measure failures • Regenerated understanding of the relationship of inputs to performance outputs • Periodic reviews and challenge of route/train operator performance delivery in line with trajectory. 	<ul style="list-style-type: none"> • New five-year performance strategies developed collaboratively with routes and train operators • Performance planning reform programme phase 2 in CP5 to focus on improving the timetable and unlocking further operational performance.
<i>We may be unable to sufficiently recover the infrastructure from a disruptive event (catastrophic asset failure, cyber-attack, extreme acts of weather etc), within acceptable timescales</i>	<ul style="list-style-type: none"> • Design of a group-wide integrated approach to business continuity management • Design of a company-wide strategy to implement cyber and information security programmes aligning business areas, functions, technology platforms and governance frameworks. 	<ul style="list-style-type: none"> • Increased focus on improvement of incident management processes and procedures • Weather Resilience and Climate Change Programme Board to continually assess vulnerability of assets • Further strategic and tactical investment to provide a more resilient network and systems landscape that will perform effectively under increased stress.
<i>Failure to adequately manage our assets and inability to demonstrate excellence in Asset Management</i>	<ul style="list-style-type: none"> • Major investment programme in asset information – ORBIS (Offering Rail Better Information Services) to improve asset information for better decision making to achieve targets • A business-wide improvement in Asset Management through delivery of Asset Management Improvement Programme (AMIP) • Whole-life cost modelling integrated with asset policy development. 	<ul style="list-style-type: none"> • Cross functional programme to create alignment of maintenance initiatives to deliver improvements and consistency in how works are planned and executed • Pursuit of accreditation against internationally recognised asset management standards.

Our approach to risk management: **Value**

Risk	Current actions	Planned
Failure to plan or deliver the CP5 outcomes, including regulated outputs	<ul style="list-style-type: none"> • CP5 business plan created by the business for the business – integrated top-down and bottom-up development • Maintain strong union relationships reinforced by continuous dialogue • Managing successful programmes mandated across all major programmes key to delivering CP5 outputs • Set up a central 'controlling' function for CP5 and beyond – Business Review team. 	<ul style="list-style-type: none"> • Improving the governance around all projects and programmes and confirming alignment with 2019 outcomes and strategic themes.
There is a threat that the required critical resources (people, plant, materials and/or access) will not be available to support the delivery of baseline programmes or additionally remitted work	<ul style="list-style-type: none"> • Strategic planning forum to review supply vs. demand and provide challenge and direction • Development of a national integrated plan and delivering work within possessions optimising use of resources • Foster strong union relationships with continuous dialogue • Development of a strategic approach to recruitment and talent development. 	<ul style="list-style-type: none"> • Implementation of critical resources management framework (plan, integrity, change control processes and strategic supply versus demand).
We fail to develop and introduce the technology our business requires to deliver our strategic outcomes effectively and efficiently	<ul style="list-style-type: none"> • Secured regulatory funding and additional industry backed funding for technology and innovation research and development investment by us and the industry • European Train Control Systems programme vision, strategy and objectives defined. 	<ul style="list-style-type: none"> • Development of an embedded research and development programme that is integrated with our supply chain • Improved real time communication with customers and other stakeholders.

How we performed

Becoming a trusted leader sets a new bar for what we do for our customers and their customers, how we do it and how we are perceived in the rail industry. Like any business, we have our key performance indicators which we use to monitor how we perform.

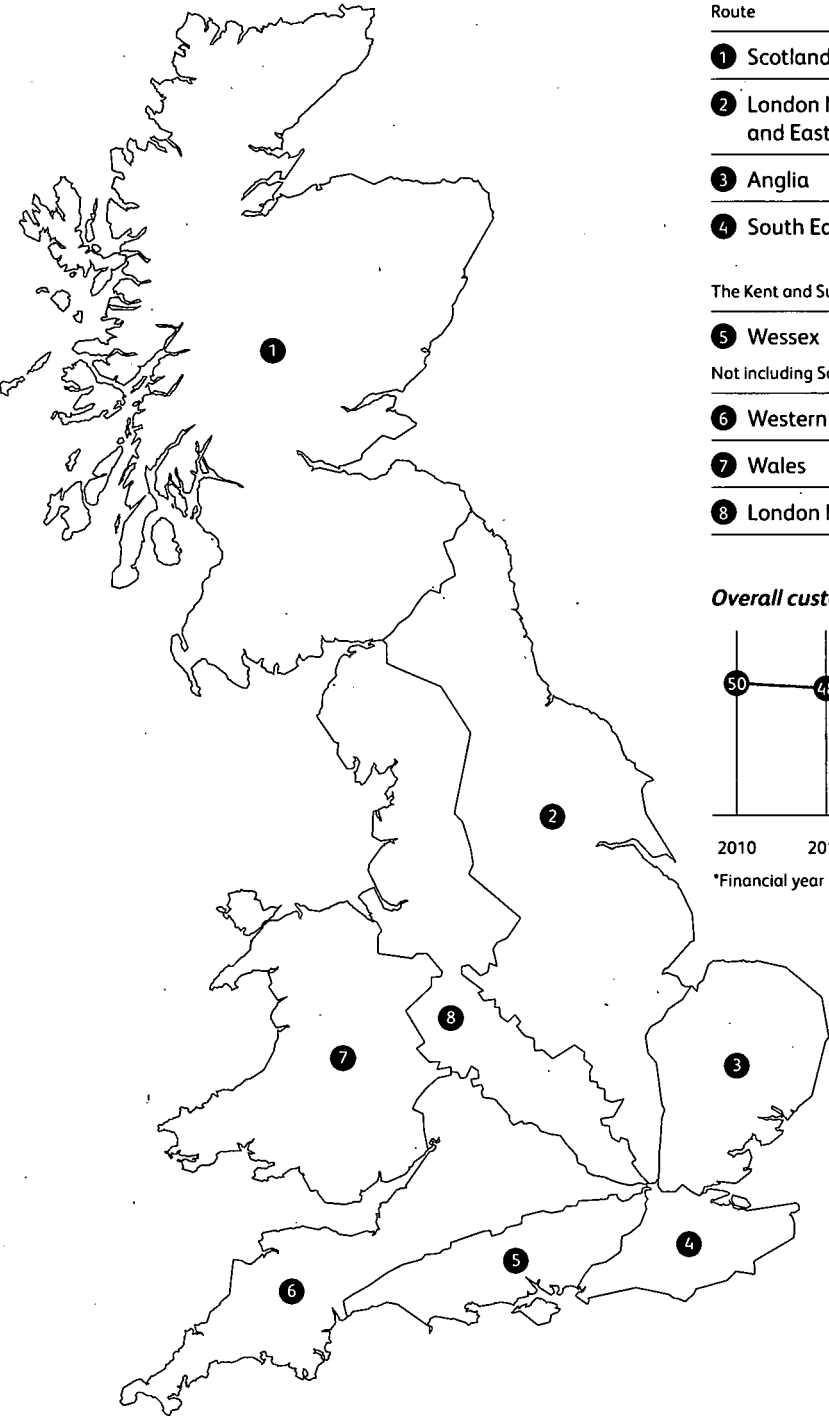
		2014	
		Actual	Target
Safety  everyone home safe every day		Passenger safety indicator The passenger safety indicator is measured as passenger fatalities and weighted injuries normalised per million passenger kilometres. The lower the measure the better.	
		0.194	0.240
		Workforce fatalities and weighted injuries The workforce safety indicator is measured as workforce fatalities and weighted injuries normalised per million employee hours. The lower the measure the better.	
		0.161	0.090
Asset Management		Asset stewardship indicator Indicator of the quality of our asset stewardship, based on asset condition, reliability and performance across our key assets. The higher the number the better.	
		0.105	0.063
Network Operations		Public performance measure Percentage of franchised operator trains that arrive 'on time' at their destination (10 minutes for long distance, five minutes for regional, London & South East and Scotland).	
		90.0%	92.0%
		Freight performance measure Percentage of freight operator trains that arrive 'on time' at their destination (10 minutes for all operators).	
		74.8%	74.9%
		Passenger satisfaction The National Passenger Survey (NPS) commissioned by Passenger Focus, provides a network-wide picture of customers' satisfaction with rail travel. This represents passengers' overall satisfaction with their journey in Autumn 2013.	
		83%	
		Customer satisfaction Customer satisfaction is established through a survey of the top managers from the train and freight operators in the UK. The survey is carried out by a third party company, GfK. This represents their overall satisfaction with the company in Autumn 2013.	
		58%	
Infrastructure Projects		Enhancement milestones completed 543 milestones were planned to be delivered over CP4. All but 24 of these milestones were delivered within CP4 and forecast to be delivered in CP5.	
		519 Delivered in CP4	24 To be delivered in CP5

King's Cross Square

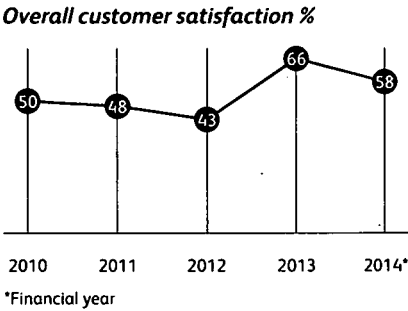
In September 2013, the 75,000 sq ft King's Cross Square was opened as the final part of the £550m redevelopment of King's Cross station and follows the renovation of the original station building. This complements the construction of a new platform and the new western concourse, which opened to passengers in March 2012. Redevelopment has helped to attract £2.2bn of private investment into a previously largely derelict and disused 67 acre site, and includes 2,000 new homes.

Customer satisfaction on our routes

Each year we measure the train and freight operating companies' satisfaction with our overall performance. The overall score received in Autumn 2013 was 58 per cent. For train operators it was 59 per cent and for freight operators 47 per cent.



Route	Customer satisfaction
1 Scotland	24%
2 London North Eastern and East Midlands	58%
3 Anglia	83%
4 South East	Kent 80% Sussex 33%
The Kent and Sussex route merged in April 2014	
5 Wessex	58%
Not including South West Trains	
6 Western	58%
7 Wales	72%
8 London North Western	59%



Asset Management

We will go from being world class in taking care of our track to becoming a world leader in the management of all our assets.

Above: North London line maintenance.

We are one of the largest asset management companies in Europe, with around 30,000 bridges, 2,500 stations and 20,000 miles of track. In delivering our vision we will need to possess first rate asset management capability. We intend to be respected world-wide as the pre-eminent source of railway systems innovation and best practice, both within and outside of the rail industry.

What we plan to do by 2019

- Be a benchmark against which organisations throughout the world assess their own asset management capabilities.

How we performed during the year

We use the asset stewardship indicator (ASI) as a high level indicator of asset performance. We achieved our ASI target for CP4 within the third year of the control period, and ended CP4 with a score 10.4 per cent better than CP3 exit.

In 2014, despite challenging weather conditions, reliability and condition improvements were seen across a range of our key assets including:

- Track geometry (in terms of poor track geometry and good track geometry) as well as rail breaks and track failures all bettering ORR CP4 end success criteria
- Signalling condition
- Structures assets subject to additional examinations
- A number of electrical power asset condition measures
- Telecoms assets condition.

Telecoms failures were higher than forecast, reflecting software issues in rolling out GSM-R (the new communication system between signallers and train drivers). A programme of the necessary software patches is now under way to resolve the issues found.

Our structures and earthworks have been particularly affected by the extreme weather over the last winter, with flooding and storm surges affecting our embankments and sea defences such as at Dawlish and the Cambrian Coast.

The key initiatives we have under way

We continue to run an overarching programme of asset management improvement, addressing all aspects of our asset management system. In 2013 this saw us accredited to PAS 55, the British Standards Institution's (BSI) publicly available specification for asset management, and we are now working towards accreditation under PAS 55's successor, ISO 55000, for which we contributed to the development of, as part of our patron role with the Institute of Asset Management.

Key initiatives include increasing the reliability of our assets and reducing the number of failures, whether track, points or signals through a process of continuous improvement using targeted maintenance, lean techniques of working, as well as the latest technology, to maintain our infrastructure.

Our ORBIS programme (Offering Rail Better Information Services) is key to our move from an approach based on 'find and fix' to one of 'predict and prevent'. This significant investment in our asset information data and systems makes it easier to capture information through the deployment of hand-held devices and advanced train-borne systems, giving us better information about how our rail network is performing, the condition our rail assets are in and where we need to make future investments.

We are also investing in the competency of our people, where we have built a competency framework for our key roles and are now developing targeted asset management training and development programmes to support individual's development.

We are also continuing to benchmark ourselves with other asset-intensive industries around the world, to identify appropriate best practice which we can implement and using this learning to further develop our plans.

Network Operations

We will continue to transform how we timetable and operate the railway, enabling us to deliver a better service for all.

Above: The new workforce development centre in York

We have a duty to passengers and freight customers to get the most out of our infrastructure and provide a reliable service on the railway. Apart from reliable assets, a key component of a reliable service is the timetable. We have to operate an increasingly busy network, in real time, responding to incidents to keep trains running to plan. Passengers are up 57 per cent in the last decade and freight is growing too – 18 per cent up on 2001.

Delivering a reliable service provides a number of challenges and at times trade-offs will need to be made, both in planning the timetable and delivering the service. We are working much more closely with the train operating companies on a daily basis, as well as with the Department for Transport and Transport Scotland to address these challenges.

What we plan to do by 2019

- Deliver for passengers and freight the best ever level of punctuality with a target of 92.5 per cent of trains arriving on time
- Operate the best possible timetable every day on the network and to be nearer our goal of operating a 'right time' timetable which uses Global Positioning System (GPS) equipment on trains to ensure the right train is at the right place at the right time.

How we performed during the year

CP4 has been a challenging period with regard to performance. At national level we ended the year 2 per cent behind our target of 92 per cent. Performance in the year has again been severely affected by weather (the fourth year in CP4 that this has occurred). The storms, gales and floods across much of Britain during the winter of 2014 demonstrated once again not only how our weather patterns are changing but also the impact that this has on the railway. Whether it has been the dramatic demolition of the seawall at Dawlish, coastal damage and land slips in Wales, rising groundwater in the Thames Valley, or falling trees in Scotland, there has hardly been a part of the network that has not been affected.

Severe weather has had the biggest impact on the performance of the railway with the impact of external delays (things that we do not have principal control over such as cable theft and suicides) significantly reduced as a result of significant industry focus in this area. We are working to better understand the impact not just of the recent battering but of the extreme weather events over the past few years. By September 2014 we will complete a series of resilience studies and identify further weather resilience plans for action in the coming months.

Performance by sector

	2014	
	Actual	Target
Public performance measure		
Scotland	91.4%	92.0%
Long distance	86.9%	89.1%
London & South East (LSE)	89.6%	92.2%
Regional	91.0%	92.4%
Freight performance measure	74.8%	74.9%

Above: Flooded signalling equipment
 Collaborative working with First Great Western during extreme weather. In early 2014, trains travelling into and out of Paddington faced a 20 per cent reduced service to normal due to signalling equipment at Maidenhead being under several feet of flood water. We worked innovatively with First Great Western, including introducing a temporary signalling system and a revised timetable, to bring service in excess of 75 per cent normal.

Over the past few years demand for long distance services has continued to grow significantly ahead of initial expectations at the start of CP4. The growing demand has put pressure on train punctuality. The railway is busier than it ever has been and so when incidents happen more trains are delayed. We expect the ORR to apply a financial penalty as a result of our failure to meet the regulatory long distance train performance in the year. The penalty has not been finally determined but could be up to £77m.

We know punctuality is extremely important to passengers. We are extremely disappointed that we did not meet the targets we were set for CP4. The reasons why were complex but one thing we did not predict was the extent of growth in passengers or train services over the last five years. We have carried out detailed analysis to explain these shortfalls against our CP4 targets focusing in particular on where train performance is affected by changes in journey times, capacity and other outputs, the assumptions which informed our planning for CP4, the impact of adverse weather to inform the recovery plans we put in place last year for the freight, long distance and LSE sectors and our plans for CP5.

We will use this analysis to inform our efforts on hitting the performance targets we have been set for the next five years. We expect the first two years of CP5 to be challenging but we are confident that with the initiatives we have underway we can meet the targets in the remainder of CP5.

The key initiatives we have under way

Each of the following key initiatives will help us to deliver the required performance:

- Apply an industry access programme to get the balance right between the services customers want and the needs of the network
- Reform performance planning to better understand the causes of delays and give us the best data to create timetables and engage with stakeholders. We are working much more closely with the train operating companies on a daily basis, as well as with the Department for Transport to ensure that new franchises enable a more accurate timetable
- Improve capacity planning to help us eliminate waste and improve our capabilities
- Use technology to increase capacity on the existing network in a more direct way by offering the prospect of allowing trains to run faster and closer together without compromising safety. The key is the introduction of the European Train Control System (ETCS) as we are planning to do initially on the Great Western Main Line and part of the East Coast Main Line before rolling out across the rest of the network. It represents the biggest change in the way we operate trains since the time of Stephenson and Brunel. The way trains are controlled today by signals operated from signal boxes along the line would have been recognisable to them, but ETCS removes the need for lineside signals and introduces instead a control mechanism in the driver's cab which relays all the information that is needed from one of 12 regional operating centres around Britain. The end benefit for passengers and freight services will be that more trains will be allowed to safely use the track. It will also have substantial benefits in terms of both reliability and the drive to reduce costs.

Infrastructure Projects

We will deliver the biggest investment programme since the Victorian era, benefiting people and businesses across Britain. We're investing now to improve services and cut emissions.

Above: Artist's impression of Glasgow Queen Street station.

Our ambition is to be the best rail infrastructure project delivery organisation in the UK. Infrastructure Projects aims to safely deliver a complex portfolio of infrastructure projects on time, in a way that:

- Represents value for money for taxpayers
- Enables our customers to realise the benefits from these investments, through increased capacity and reliability
- Is consistent with our strategy.

What we plan to do by 2019

- Deliver a step change in whole life, whole system capability
- Deliver demonstrated value from working with our partners
- Win business in competition.

Enhancement milestones

These represent a specific set of commitments across the enhancement portfolio that were agreed and change controlled with our regulator. They are published in the enhancements delivery plan which is updated on a quarterly basis and the delivery performance is measured across the control period rather than annually. 543 milestones were planned to be delivered over CP4. All but 87 milestones were delivered early or on target, of which 24 are forecast to be delivered in CP5 and one is in the process of being change controlled with the regulator.

Possession hand back and cancellations performance

98 per cent of possessions (a blockage of a running line, usually taken for work involving engineering trains) were handed back on time or early. The table below shows the number of incidents, resulting delay minutes and cancelled trains:

	2014	2013	Variance
Number of incidents	380	314	+21%
Delay minutes	109,767	72,806	+51%
Trains cancelled	2,235	1,231	+82%

The key initiatives we have under way

The key enablers to success in CP5 are:

- Implementation of the Projects Portfolio, Programme, Project Management Maturity Model (P3M3) for assessment and improvement planning
- Improved contingency management driving effective risk appraisal and efficiency recognition
- Leveraging the renewals efficiency delivery into enhancements creating an appropriate level of efficiency challenge across the Infrastructure Projects portfolio
- Continuation of the Infrastructure Projects change programmes to improve strategic capabilities
- Embedding the efficiency challenge whilst mitigating the risks
- Corporate efficiencies through ORBIS (offering rail better information services) which benefits unit cost and focuses on data cleansing, integrity and future proofing
- Working more closely with our partners through alliances – creating a common focus and shared approach will drive down costs, reduce risk and lead to more efficient and timely delivery
- Deliver our CP5 commercial strategy – supply chain collaboration and increased use of framework agreements aimed at driving efficiencies and reducing contractor claims.

Property

We provide high-quality professional property expertise that reduces industry costs, improves the passenger experience and creates great places for people, businesses, and communities to thrive.

Above: Paddington Lawn

As an initial phase of the Paddington masterplan, we are investing £12m to improve the environment within Paddington Lawn whilst improving its passenger flows and linkages with the train shed.

Above: Manchester First Street

We have formed a property alliance with Manchester City Council and Transport for Greater Manchester to take forward plans to regenerate Manchester City Centre.

Above: Artist's impression: West Hampstead

Our joint venture with Ballymore at West Hampstead will deliver 197 new flats, including 53 affordable, together with 8,700 sq ft of retail space adjacent to the station.

We are one of the largest land and property owners in the country and during the five-year period which ended on 31 March 2014, our commercial activities generated £1.4bn for re-investment in our rail estate. This is enough to pay for the complete transformation of King's Cross and Birmingham New Street stations, or put in place 5,000 km of new railway.

We work in partnership to develop surplus railway land, including multi-pound commercial schemes above our station at Birmingham New Street and through joint ventures with the likes of Ballymore, Kier and The Office Group.



Value of our investment portfolio
2014 £856m
2013 £751m



Commercial property income
2014 £266m
2013 £257m



Occupancy rates at our business space estate
2014 95%
2013 95%



Retail space at our managed stations
2014 510,000 sq ft
2013 505,000 sq ft



Like-for-like retail sales growth
Network Rail managed stations +6.1%
British Retail Consortium +0.75%
From 1 April 2013 to 31 March 2014

The key initiatives we have under way

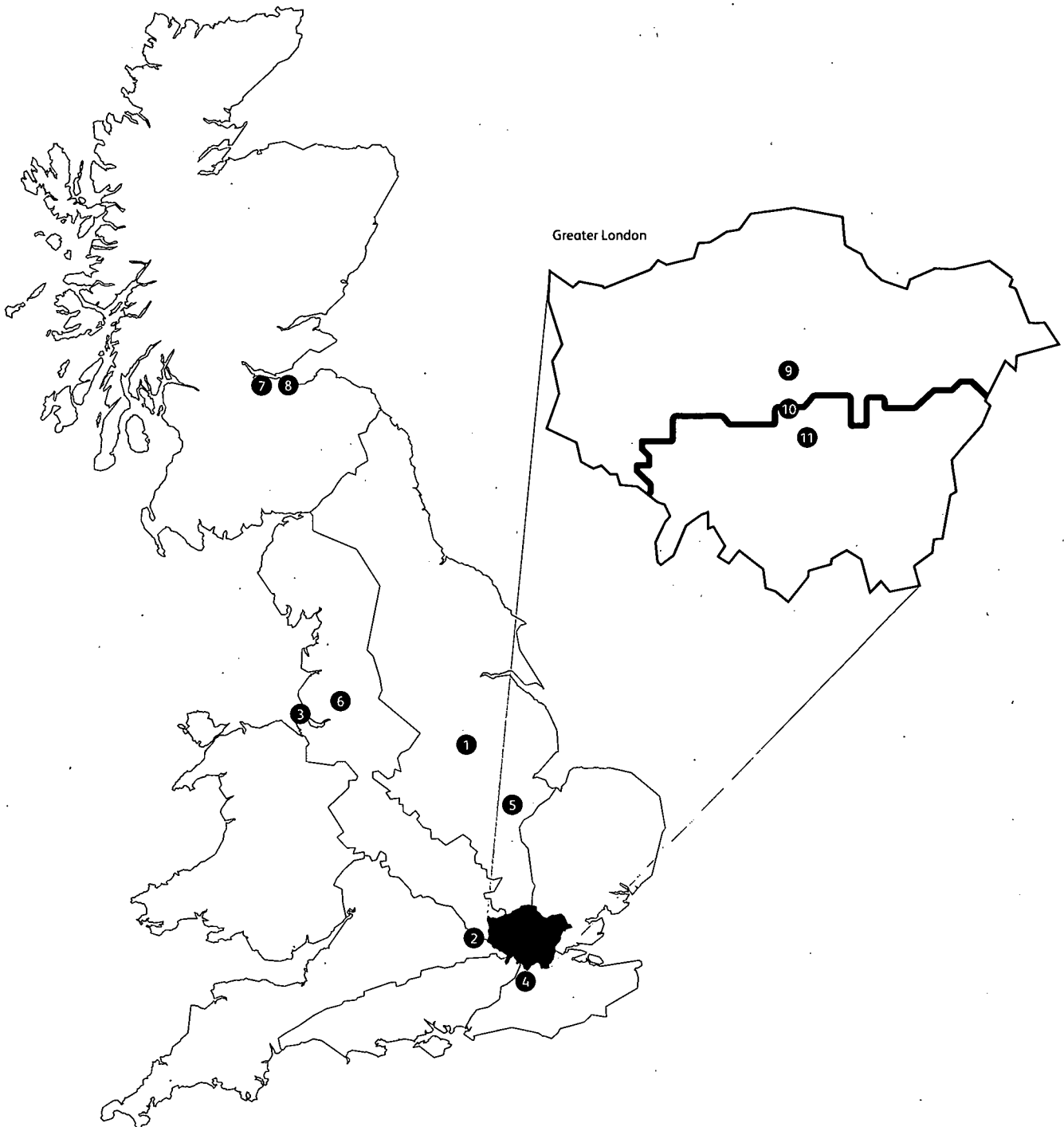
We have an ambitious growth agenda for CP5 that will not only boost our income but also help to regenerate areas around our estate and bring more class-leading environments to rail passengers, colleagues, tenants and neighbours.

Over the next five years we will invest £38bn to improve our station facilities, enhance the quality of our assets and develop tenant communities with a strong sense of purpose.

We are also striving to expand our growing network of partners, drawing on the sector expertise of others to maximise the value of our land and property portfolio.

The improvements we delivered during the year

This map shows what we delivered in the past year and what the improvements mean all over the country.



Locations

1 Nottingham Hub

Nottingham station platform 4 complete

A major re-signalling and track renewals project took place in Nottingham. The £150m project will improve reliability, reduce delays and create the capacity to cope with increasing numbers of passengers.

2 Reading Improved station capacity

Improvements included the opening of two new entrances, four new platforms, a new 110 metre long bridge as well as escalators and lifts to provide step free access to the new platforms. Reading station is currently used by 14 million passengers annually, a figure that is predicted to reach 30 million by 2030. These improvements are therefore vital to cater for future increases in demand.

3 Liverpool Lime Street

Underground complete

Liverpool Lime Street station is the gateway to Liverpool city centre. It is the focus of two major development schemes designed to reveal the grade two listed structure and provide a new focus for the city.

4 Gatwick Airport

Station complete

Around 1,300 metres of track was laid and 250 metres of new platform was completed, helping to provide a better service for passengers going to the airport. This investment will hugely benefit more than a third of Gatwick Airport's 35 million passengers who currently arrive by train and is vital to coping with projected increases in demand along the railway in Sussex.

5 Peterborough station

Station complete

The £43m improvements at Peterborough station saw the addition of a new station building as well as more easily accessible platforms after new footbridges and lifts were installed. The work will mean improved train services, with more trains to different destinations, and shorter journey times. Moreover the work will also support the predicted 100 per cent growth in demand for services to London over the next 25 years.

Routes

6 North West Electrification (NWE)

Newton-le-Willows (Phase 1)

Electric trains are now able to run between Manchester Airport and Scotland, following completion of Phase 1 of the NWE, which saw 58 track km electrified and 210 km of copper or aluminium cable installed.

7 Edinburgh to Glasgow

Improvements Programme (EGIP)

Opening the re-developed

Haymarket station to the public.

Haymarket has been transformed to create an efficient and attractive facility, greatly improving passenger experience. With a new main concourse building, Haymarket now has 10 times more public space. Moreover, as well as providing step free access to all platforms, the new main entrance also provides direct access to the tram line along Haymarket Terrace, creating an integrated travel hub for the city.

8 Edinburgh Waverley

Package 4 Main Building complete

Edinburgh Waverley has been transformed by a £100m investment in the station and its facilities, creating an environment that meets the needs of passengers in the 21st century while preserving Waverley's rich heritage.

Greater London

9 King's Cross

King's Cross Square works complete

The 75,000 sq ft public space was the final part of the redevelopment of King's Cross station to be completed and follows the renovation of the original station building and its platforms, and the construction of the spectacular new western concourse, which opened to passengers in March 2012.

10 London Blackfriars

Station complete

The first station to span the Thames, offering passengers longer trains and more frequent services. Furthermore the station now boasts a new entrance on the south bank of the Thames, four platforms and a redeveloped London Underground station, providing a better interchange between national rail and London Underground services. The roof of the station is also covered with solar panels, which meet 50 per cent of the station's energy demands, significantly lowering our carbon footprint.

11 London Bridge

Platforms 14 and 15 complete (Phase 1)

The first phase of Thameslink has been completed, with platforms 14 and 15 open. This investment has helped to remove bottlenecks and will play a key role in facilitating the introduction of a more spacious and frequent train service in the future. Over the course of the project, London Bridge will be transformed, with a bigger and better station being delivered to customers.

Group finance director's review

This year was the last in CP4. It has seen record levels of investment in our infrastructure and we are well placed for achieving our objectives in CP5.

Capital investment of £6.9bn was 36 per cent higher than last year and more than any year in the company's history. Part of the investment was funded by an increase of £2.6bn in our debt; however our primary gearing measure of regulatory asset base to regulatory net debt of 65 per cent remains comfortably within the regulatory limit of 75 per cent.

The key financial results were:

For the year ended 31 March	2014 £m	2013 £m
Revenue	6,333	6,197
Operating profit	2,001	2,207
Profit before tax	1,035	747
Profit after tax	1,256	677
Net cash from operating activities	2,698	2,703
Net debt	(32,987)	(30,358)
Net assets	8,182	8,013
Railway network fixed assets	49,833	46,411
Value of investment property	856	751
Capital expenditure	6,873	5,050

Financial review of the year

Revenue

The majority of our income is determined by the ORR in advance of each five-year control period, based on an assessment of the amounts required to cover net expenditure and to finance our investment activities. 62 per cent of our income for the control period is in the form of network grant from the Government. A further 15 per cent comes from fixed charges to operators, leaving 23 per cent coming from variable charges to train operators and from other sources of income, mainly property rents. Our income from operators is reduced by compensation paid to operators under the performance regime and our grant income by rebates that we provide to Government.

Performance regime

Train operators pay us to access the railway network and we compensate them when they are not able to run their trains due to asset failures or other events such as suicides and extreme weather, for which Network Rail bears the risk.

As with last year, train performance suffered through a combination of asset failures, operational planning issues and a period of intense bad weather, while the thresholds at which compensation is paid become more challenging each year. Consequently, we have incurred costs of £197m (2013: £136m) for unplanned disruption.

When we need to carry out engineering work, we may restrict operators' access to the railway network. We may also agree emergency timetables when there is prolonged disruption – for instance around Dawlish and the Somerset Levels – or we expect circumstances to be such that the railway will suffer disruption – such as the restriction of services on the day of the St Jude storm.

As the amount of renewal spend has grown, this has driven a significant increase in our access requirements even though we have got better at planning work in possessions. Together with the disruption caused by the long-term effects of severe weather, we have incurred costs of £167m (2013: £122m) in respect of planned disruption which more than offsets the access charge supplement of £146m (2013: £149m).

Property

During 2014 property income included within revenue grew by £5m (2.1 per cent) to £238m (2013: £233m). The principal drivers of income growth were the Property enhancements programme, retailers' sales growth at our managed stations and rental growth from our commercial estates tenants.

“Capital investment was 36 per cent higher than last year and more than any year in the company's history.”

Disruption has had a significant financial impact

For the year ended 31 March	2014 £m	2013 £m	2012 £m	2011 £m	2010 £m
Revenue before performance regime	6,551	6,306	5,998	5,726	5,626
Net Schedule 4	(21)	27	86	39	37
Net Schedule 8	(197)	(136)	(80)	(53)	5
Total revenue	6,333	6,197	6,004	5,712	5,668

Above:
A series of severe storms resulted in significant costs for compensation to train operators.

Group finance director's review continued

"As the amount of renewal spend has grown, this has driven a significant increase in our access requirements even though we have got better at planning work in possessions."

Significant property enhancements that completed during the year to reinforce our strategy of creating 'destination stations' at our managed stations included further retail improvements at Waterloo station, with the opening of a Foyles book shop and the launch of 'Waterloo Motion'; at 40 metres long this is Europe's largest LED screen. We completed the Epsom commercial development, which funded a fully refurbished station; this was the first site to be completed by our Solum Regeneration joint venture with Kier Property. Including the acquisition of over 100 freight sites, property enhancements spend was £266m (2013: £42m).

Net property sales were £41m (2013: £39m) for the year. Significant sales included the sale and lease back of Enterprise House in Paddington.

Operating costs

Operating costs increased this year by £342m to £4,332m (2013: £3,990m), including the impact of a number of one-off costs. £112m of the increase related to depreciation.

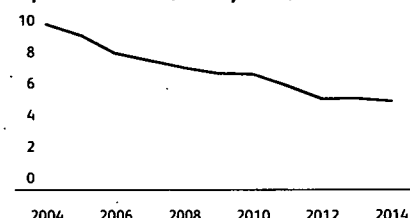
The average number of employees again fell slightly to 35,141 (2013: 35,190). Employee costs increased £121m (7 per cent) to £1,910m before capitalisation. This includes a £34m increase in IAS19 pension costs following the change in accounting and the impact of pay rises in the year.

Other costs increased by £187m (11 per cent) to £1,873m. This included the provision for the financial penalty we expect the ORR to apply as a result of us missing the regulatory long distance train performance target in the year. The penalty has not been finally determined but could be up to £77m. 86.9 per cent of trains arrived on time compared to a target of 92 per cent, with the penalty assessed at £1.5m per 0.1 per cent shortfall in performance. Further allowance of £68m (2013: £5m) was made for redundancy costs being incurred as part of our management headcount reduction and the next phase of relocation of staff to our national

centre in Milton Keynes. These initiatives are important steps towards achieving the savings in overhead costs we need to make in the next control period.

The impact of one-off costs in particular means that costs per train mile are only slightly lower than they were two years ago.

Controllable operating costs £ per train mile (2014 prices)



Excludes impact of £77m ORR financial penalty for missed long distance train performance in 2014

Profit

Reflecting the factors above and a £96m property surplus, total profit from operations for the year fell to £2,097m (2013: £2,204m).

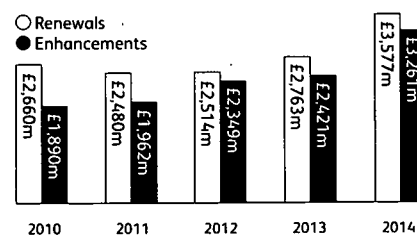
The impact of the valuation of financial instruments was a gain of £304m (2013: charge of £43m), while finance costs were lower mainly due to change in the way the charge on index linked bonds is accrued. Consequently, profit before tax for the year increased from £747m to £1,035m.

Capital expenditure

We invested an unprecedented £6,873m in the railway network this year, up from the already high £5,050m last year.

Capital expenditure

This includes investment properties



Investment levels have increased in CP4

Above:
New rail at Tata Steel's Scunthorpe plant.

We spent £3,296m on enhancements, increasing the capacity and capability of the railway for the future. Significant progress has been made on major projects including Thameslink, Reading station area, Birmingham New Street station, Crossrail and electrification; however equally important are the many investments to improve train performance, line speed, freight access, platform lengths, power supply and disabled access.

As our asset knowledge and delivery plans have matured, we have spent £3,577m renewing our assets. We have delivered increased volumes of track, signalling and structures renewals, utilising new technology where possible and working more collaboratively with train operators following devolution of decision making to routes.

Financial framework

Financing activities

We finance our investment activities by raising debt. The cost of servicing this debt is addressed as part of the five-yearly regulatory settlement. Following the recent decision by the Office for National Statistics to reclassify us as a central government body the Government has determined that, in future, value for money for the taxpayer will best be secured by us borrowing directly from the Government rather than issuing debt in our own name.

Borrowing

During the year, debt repayments of £3,975m and part of the £6,873m investment programme were financed through debt issuance of £5,104m and a reduction in cash balances of £2,304m.

For the year ended 31 March	2014 £m	2013 £m
Borrowing to fund investment	1,129	3,548
Borrowing to refinance	3,975	1,203
Bonds issued in the year	5,104	4,751

Net debt increased in the year from £30,358m to £32,987m as a result of the investment in the network. At the end of the year, the key ratio of debt compared to the regulatory asset base (RAB) was 65 per cent (2013: 64 per cent) and well below the ceiling of 75 per cent set in the network licence.

Details of our debt, derivatives and related risk management can be found in the notes to the accounts.

The railway network

The railway network that we own and have a licence to operate is included in the accounts at a value that represents what a third-party purchaser would pay for it. The basis of this valuation is set out in note 12 to the accounts and comes from an assessment of the cash flows that are forecast to arise from the asset. The starting point for this valuation is the RAB.

Subject to certain criteria established by the ORR, each year capital expenditure is added to the RAB and amortisation is deducted. The ORR can make deductions from the RAB in the event that we do not achieve our required outputs, for example not meeting required train performance or breaching a licence condition, or where the ORR wishes to make a retrospective funding adjustment. The valuation of the railway network includes a total reduction of £2,188m (2013: £436m) in respect of missed outputs, projected overspend and historic taxation. This is our estimate, as the extent of outputs adjustments has not been finalised.

In respect of outputs in CP4, we have made allowance for the estimated adjustments for missed train performance, asset management, enhancement milestones and network availability, offset by the estimated double count between each item. This comes to £189m in total. The adjustments are determined by the ORR and we have no right of appeal.

“We have delivered increased volumes of track, signalling and structures renewals, utilising new technology where possible and working more collaboratively with train operators.”

Group finance director's review continued

"We have not ended the control period where we wanted to be. However, the balance sheet is strong enough to see us through this."

As the valuation of the railway network is based on projected cash flows, we have considered the potential for under performance in CP5, both in terms of the financial settlement and the required outputs. This is highly subjective and uncertain. While we believe we will achieve the required outputs as set out in our Delivery Plan, we believe there is a high risk of spending more than the settlement. Our current plans indicate a potential overspend on compensation to operators, on track renewal costs and on interest, amounting to an estimated £660m.

Lastly, as part of the determination for CP5, the ORR reduced our RAB by £1,339m in respect of an identified tax 'double count'. As there is no further opportunity to challenge this position, this reduction flows through to the value of the railway network.

Post balance sheet events

Except as disclosed above, there have not been any significant post balance sheet events, whether adjusting or non-adjusting.

Reclassification

In December 2013, the Office for National Statistics published their conclusion that a change in European accounting rules meant we are to be reclassified as a central government body. Our borrowing arrangements are changing as noted on page 43. Otherwise, the reclassification does not have an immediate impact on our corporate status or activities, though it is inevitable that there will be some change when the reclassification actually takes effect in September 2014. We have an agreement with the Department for Transport setting out the shared objective of not changing anything unnecessarily and we will work together over the coming months to preserve as far as possible our ability to manage our business independently and on a long-term basis.

Summary

This has been another difficult year for Network Rail, in which significant progress on investment has not been matched by strong operational performance. We have not ended the control period where we wanted to be. However, the balance sheet is strong enough to see us through this.

We must remember that while we are missing today's challenging targets, in many respects we are performing at historical highs. In many areas, such as asset condition and increasing capacity, we have made very real progress. We have made real savings in costs and we have spent considerably less than assumed five years ago.

The regulatory settlement for CP5 is going to be a challenge, especially for train performance. We have published our delivery plan, now we need to deliver it.



Patrick Butcher
Group finance director

11 June 2014

How we act responsibly

By acting responsibly, we will make our business more efficient, protect the value of our assets and deliver a railway fit for future generations.

Our approach to sustainable development

Our sustainable development strategy
Our group-wide sustainable development strategy 'Delivering a railway fit for the future' was published in 2013 and identifies key themes for focus on over the next 10 years. We aim to achieve the following outcomes:

2014


- Our sustainable development strategy is implemented across the business
- We are recognised as central to a sustainable economy.

2019

- We reduce carbon emissions and improve energy efficiency
- We reduce carbon intensity of our electricity supply by 14 per cent
- We embed climate scenarios in our infrastructure investment decisions
- We invest in our people enhancing our reputation as a great place to work.

2024

- Rail is a cornerstone of sustainable economic growth
- Rail improves social and economic opportunities and benefits Britain's natural environment
- We are a strong, prosperous and sustainable business
- Rail supports and sustains communities.

 **Our sustainable development strategy is available at networkrail.co.uk/SustainableDevelopment.pdf**

2014 in action

Is Network Rail on track for sustainability?

Above: The Guardian newspaper headline.

The Guardian roundtable in association with Network Rail

During the year, we met with sustainable development leaders from a wide range of industries and interest groups to review our plans for a sustainable rail network. We have taken the outcomes from the session to work closely with routes and functions to make sure we have targets that are stretching and focused on where we can best add value.

Our energy efficiency measures

Effective management of energy consumption improves the sustainability credentials of rail travel and makes it a more attractive mode of transport compared to travel by road or air. In CP4 we set ourselves a target to reduce carbon

emissions from our offices, depots and managed stations by 20 per cent based on 2007 consumption figures. Our energy consumption data for 2014 is still being finalised but preliminary indications are that we reduced relevant emissions by 18 per cent compared to the 2007 target. The two per cent shortfall was due in part to the installation of new energy-consuming assets to expand and modernise our infrastructure which partly offset our energy reduction efforts. Our target for CP5 is to reduce carbon emissions from non-traction electricity, gas and fuel for our road vehicle fleet (diesel and petrol) by 11 per cent. The 11 per cent reduction applies to the emissions in the final year of CP5 compared to the final year of CP4.

Due to the varied nature of our assets we do not presently believe that there is a suitable normalising factor to apply to our emissions data to give a meaningful intensity ratio as the nature of our business means that annual turnover is relatively flat. In addition, by continuing to modernise our infrastructure with 21st century technology we will inevitably need to invest in additional energy consuming assets.

	2014 Tonnes of CO ₂ e	2013 Tonnes of CO ₂ e
Scope 1 – CO ₂ e emissions	64,465	65,559
Scope 2 – Combustion of fuel and operations of facilities	194,247	237,248
Scope 3 – Purchase of electricity, heat or steam for cooling	21,171	3,375
Total	279,883	306,182

Our methodologies

Scope 1 includes greenhouse gas emissions from natural gas, diesel, petrol and liquefied petroleum gas road vehicle fuel, gas oil and calor gas.

Scope 2 includes greenhouse gas emissions from electricity consumption.

Scope 3 includes greenhouse gas emissions from electricity transmission and distribution, business travel and aviation fuel.

The carbon emissions relate to our operations in England, Wales and Scotland for the periods shown and have been calculated using the prevailing DEFRA/DECC greenhouse gas conversion factors valid up to 31 May 2013. The figures exclude:

- Electricity purchased by us for train traction purposes for use by passenger and freight train operators
- Small quantities of fuels bought through local arrangements
- Energy used in accommodation rented by us where the energy is included within the landlord service charge
- Energy supplied by us for use by our tenants
- Heat purchased from our third party central heating provider for our National Centre offices in Milton Keynes and Sulphur Hexafluoride (SF₆) losses from our high voltage switchgear, as this data is not yet available.

How we act responsibly continued

2014 in action

Blackfriars – the largest solar-powered bridge in the world

The Thameslink team with solar panel supplier Solarcentury were awarded best project at the British Renewable Energy Awards for the rebuilding of Blackfriars bridge. Photovoltaic (PV) cells were incorporated as part of the bridge and station renewal, meaning 50 per cent of the station's energy demand is powered from renewables, reducing CO₂ emissions by over 500 tonnes a year. This achievement supports our CP5 targets to reduce emissions and embed sustainable design in our capital programmes.

+ Information on our environmental stewardship can be found in our 2014 sustainability report which will be published later this year at networkrail.co.uk/EnvironmentalStewardship

Investing in our people

We will create an environment that promotes accountability, opportunity and diversity. This will help us to become an employer of choice.

The diversity composition of our people

We are one of the largest employers in the country, with 34,000 employees, many of whom have spent their entire careers at Network Rail. We recognise that to be a trusted industry leader and to attract the best talent our approach to diversity and inclusion is important.

Our employment policies follow best practice in respect to equal opportunities but we know that to make real changes in the composition of our workforce it is the culture of our business that will create a more open, inclusive and diverse organisation.

2014 in action

Above: As part of our ongoing engagement with Stonewall and to mark LGBT History month we launched a campaign in partnership with them.

Our people networks

During the year we launched the following groups for our employees – women, lesbian, gay, bisexual and transgender (LGBT), black, asian or multi-ethnic (BME) and multi-faith. These networks aim to target engagement and provide employees the opportunity to influence our business.

The health and well-being of our people

We are committed to the health and well-being of all our people. We recognise that supporting better health and well-being is a key driver for improved safety, sustainability and engagement. We have developed a broad and ambitious strategy focusing on occupational health, physical and mental well-being. We are developing appropriate systems and processes that support the good health and well-being of our people.

Our people profile as at 31 March 2014

	All employees	Senior managers*	Board
Average age	43	49	58
Women	14.3%	12.7%	14.3%
Black, Asian or Minority Ethnic (BME)**	5.9%	1.8%	0.0%

* Our strategic leadership group, comprised of 55 employees, are classified as the most senior individuals within the group.

** BME consists of employees that do not begin with white in their origin. Non-BME consists of all employees that begin with white in their origin. Approximately 15% have not declared or specified their origin.

2014 in action

One of our key focuses is reducing the occurrences of preventable health conditions and becoming a more inclusive and supportive organisation for those people who have, or have had, mental health problems. We are working with Nuffield Health to provide our employees with information on stress awareness, healthy eating and exercise.

Engagement with our people

We recognise that to build a high-performance culture we need engaged employees who have the freedom to innovate and the confidence to challenge the status quo. To facilitate this the following mechanisms are in place: a group intranet site, management briefings, internal films, magazines and news bulletins. Business briefings are held annually, across the country, where employees are updated on our direction and have the opportunity to challenge our directors and senior managers.

2014 in action

74%

Employee engagement

Your voice

During the year, we relaunched our employee engagement survey 'Your Voice'. The questionnaire was deliberately set out as voluntary participation and we had a response rate of 46 per cent. The outcome showed a 74 per cent engagement measured on the principles of 'Say' (perception), 'Stay' (committed) and 'Strive' (extra mile). We are currently working on feedback to improve this further.

This score benchmarks well with other businesses.

Development of our people

Recruitment, development and training are the cornerstones of our management system. We continue to review and enhance the processes we employ to ensure that we consider equality, disability, ethnicity, capability, competence and business needs as part of the recruitment and employment process. We support a number of award-winning career-entry programmes to refresh our talent pipeline from large apprenticeships, graduate recruitment and sponsored MSc and HND courses.

2014 in action

York workforce development training centre

We have just opened our state-of-the-art learning facility in York which will sit alongside our new rail operating centre. This facility will support the creation of a skilled workforce who can meet the challenges of running a 21st century railway system.

The facilities boast simulators for operational training and a training track – the first of its kind able to simulate night-time working conditions indoors. Alongside, this is a welding facility, an external training track, full-size overhead line training span and a complement of distribution equipment.

Respecting our communities

Positive relationships with our communities is important for developing and inspiring our business alongside contributing to wider society.

Working with our neighbours

Up to 20 million people live or work within 500 metres of the railway boundary and on average a third of them each year will be impacted in some way by work carried out. We aim to notify local people of works and engage with communities where larger scale projects are being delivered. In addition, we will investigate all lineside issues from graffiti through to litter and fly-tipping.

2014 in action

Ordsall Chord rail link development

We have been fully committed to early and thorough consultation with the local community during the planning stages of Ordsall Chord. A phased approach to consultation was adopted, enabling residents and interested parties to comment on the emerging plans. Approximately 10,000 leaflets were distributed to residents living in the vicinity of the development site inviting them to a series of public exhibitions. Extensive consultation material was also made available online. Strong working relationships were established with ward councillors and the local residents' forum to explore specific issues affecting future line side neighbours. Our approach to community consultation was agreed with local authorities prior to implementation.

Working with charities

We support large and small charities across Britain – especially those connected to what we do – where our money and practical support can benefit communities.

In February 2014, our employees voted CLIC Sargent as our charity of choice for 2014 to 2016. Action for Children was our charity partner for 2012 to 2014 and we donated a total of £2,018,248.72 over the course of the two years through employee fundraising, payroll giving, gifts in kind, volunteering time and corporate donations.

2014 in action

Reverse-leadership challenge

During the year, senior leaders completed the refurbishment of the garden at the Action for Children Centre in Walsall. The senior leaders were supervised by a number of graduates and apprentices who had been tasked with leading the project.

Our approach to human rights

A respect for human rights is implicit in our approach to working in a safe, open and honest way. We aim to maintain the highest level of integrity in our dealings with our employees, contractors and suppliers. This is embedded in our behaviours and the way we work.

Directors' approval statement

The strategic report has been signed on behalf of the board of the company.



Richard Parry-Jones

Chairman

11 June 2014

1 Richard Parry-Jones
Chairman (62)
Appointed to the board: 2012

Skills and experience

Richard has extensive experience of the automobile and engineering industry having joined Ford Motor Company as an apprentice before working in multiple disciplines around the world, eventually becoming group vice president of Global Product Development and chief technical officer. He has been recognised for his leadership of the development and introduction of breakthrough technologies in vehicle safety and sustainability. He is a fellow of the Royal Academy of Engineering, the Institution of Mechanical Engineers and the Royal Society of Statistical Science. Richard has been awarded a CBE for his services to the automobile industry.

Current external appointments

Senior independent director of GKN PLC; honorary president of the High Speed Sustainable Manufacturing Institute; visiting professor of the faculty of Engineering at Loughborough University; co-chair of the UK Automotive Council; council member of the Royal Academy of Engineering and of Bangor University.

Committee membership

Nomination and corporate governance committee; policy and performance committee; remuneration committee; safety, health and environment committee; treasury committee.

2 Mark Carne
Chief executive (55)
Appointed to the board: 2014

Skills and experience

Mark was formerly executive vice president for Royal Dutch Shell plc in the Middle East and North Africa, responsible for the company's business in a vital but volatile region at a time of significant political change. Before taking on that role he was executive vice president and managing director for BG Group plc in Europe and Central Asia. Mark joined BG from Shell where he worked in a variety of roles during a 21-year period – including responsibility for Shell's oil and gas platforms in the North Sea and as managing director for Brunei Shell Petroleum. Mark is a fellow of the Institution of Mechanical Engineers.

Responsibilities

Whilst the board is ultimately responsible for the success of the company, operational management is delegated to the chief executive and the executives working for him. Mark is accountable to the board for all elements of the company's business, and specifically for safety performance.

Current external appointments

Independent governor of Falmouth University; senior advisor for Adamant Ventures LLP.

3 Patrick Butcher
Group finance director (46)
Appointed to the board: 2009

Skills and experience

Patrick joined the company as group finance director. Patrick's former finance director positions include English Welsh and Scottish Railway (now DB Schenker), Mapeley, London Underground and King's College Hospital. His early career was at Deloitte & Touche as a management consultant and auditor. He is a member of the Institute of Chartered Accountants (South Africa).

Responsibilities

Patrick is responsible for a range of corporate services that support the whole business by providing business services, specialist expertise and advice. This includes: finance, contracts and procurement, human resources, information management, property and other services such as legal, tax, national delivery and internal audit.

Current external appointments

Member of British Transport Police Authority.

4 Robin Gisby
Managing director,
Network Operations (57)
Appointed to the board: 2008

Skills and experience

Robin has been employed by the company and its predecessor since 1997 and has held a number of senior executive positions, including two regional director positions. He was a member of the Olympic and Paralympic Transport Board and has been a member of the British Transport Police Authority. He has a first degree in Engineering Science and an MBA. He is a chartered engineer and a fellow of the Chartered Institute of Transport.

Responsibilities

Robin leads the Network Operations function which is responsible for the safe running of the railway every day. In addition, to safety of passengers and the workforce, Network Operations is responsible for train paths, timetabling, train movements, improving performance and meeting the needs of customers. This function is split into routes, led by a route managing director, and owns and manages the business relationships with the passenger and freight operators and external commercial stakeholders.

5 Paul Plummer
Group strategy director (48)
Appointed to the board: 2008

Skills and experience

Paul joined the company in 2002 and is currently responsible for the group Strategy and Planning function. Prior to joining the company he was chief economist and director of Economics and Finance at the Office of the

Rail Regulator. He has also held senior advisory positions at National Economic Research Associates, NM Rothschild and Accenture. He holds a degree and MSc in Economics.

Responsibilities

Paul leads the group Strategy and Planning function which is responsible for developing medium and long-term company strategy and plans and for the development of the railway network. It is responsible for making sure that the regulatory framework is understood and the company focuses on robust, sustainable, and consistent deliverables that reflect the corporate goals. This work is central to driving good business planning practice in the business units to deliver current control period commitments and developing plans for the future.

Current external appointments

Chairman of the Planning Oversight Group; director of the Rail Delivery Group; vice president of the European Rail Infrastructure Managers.

6 Malcolm Brinded
Non-executive director (61)
Appointed to the board: 2010

Skills and experience

Malcolm had a 37-year career at Royal Dutch Shell plc, where he served 10 years on the main board, latterly as executive director responsible for Upstream International and prior to that for global Exploration and Production. Previously he was chairman of Shell UK. He is a fellow of the Institutions of Civil and Mechanical Engineers and of the Royal Academy of Engineering. He has honorary doctorates from Aberdeen and Robert Gordon Universities. Malcolm has been awarded a CBE for his services to the UK oil and gas industry.

Current external appointments

Non-executive director of CH2M Hill and BHP Billiton PLC; chairman of the Shell Foundation; vice president of the Energy Institute.

Committee membership

Chair of safety, health and environment committee.

7 Mike Firth
Non-executive director (71)
Appointed to the board: 2004

Skills and experience

Mike has 40 years' experience in the financial services sector providing a full range of services to major companies including project and acquisition finance in the UK, New York and Los Angeles. His last executive post was head of Corporate Banking at HSBC Bank Ltd. He was previously a non-executive director of Somerfield plc and First Technology plc. He is an associate of the Chartered Institute of Bankers and a fellow of the IFS School of Finance.

Board of directors continued

Current external appointments

Non-executive director of Communis plc and Henderson European Focus Trust plc.

Committee membership

Audit and risk committee; remuneration committee; chair of treasury committee.

8 Chris Gibb

Non-executive director (50)

Appointed to the board: 2013

Skills and experience

Chris is one of Britain's most experienced rail figures having worked in the industry for more than 30 years. After a career of operational roles in England, Scotland and Wales he became managing director, Wales and Borders Trains. He joined Virgin Trains as managing director, CrossCountry before becoming chief operating officer in 2007, responsible for Virgin's West Coast safety, operations, stations and customer service. He retired from this role in November 2013.

Committee membership

Policy and performance committee; safety, health and environment committee.

9 Lawrie Haynes

Non-executive director (61)

Appointed to the board: 2010

Skills and experience

Lawrie is currently president – Marine and Industrial Power at Rolls-Royce plc. He has extensive experience in the aerospace, telecommunications and the public sector having been chief executive at White Young Green Plc, British Nuclear Group and prior to that being a board director of BNFL plc. He was also chief executive of the Highways Agency. He holds a degree in business law, an honorary doctorate in Engineering and is a fellow of the Chartered Institute of Logistics and Transport.

Current external appointments

President – Marine and Industrial Power of Rolls-Royce plc; Chairman of the Royal Air Force Benevolent Fund.

Committee membership

Audit and risk committee.

10 Janis Kong

Non-executive director (63)

Appointed to the board: 2010

Skills and experience

Janis's executive management experience has been formed through a 33-year career with BAA, during which she held a number of senior operational roles including being a director of BAA Plc and chairman of both Heathrow Airport Ltd and Heathrow Express. Prior to that she was managing director of Gatwick Airport. She was previously a non-executive director of the Royal Bank of Scotland Group Plc. Janis has an

honorary doctorate from the Open University and has been awarded an OBE for her services to transport and regional development.

Current external appointments

Non-executive director of Kingfisher plc, Portmeirion Group PLC, TUI Travel PLC and Copenhagen Airports A/S.

Committee membership

Audit and risk committee; nomination and corporate governance committee; safety, health and environment committee.

11 Keith Ludeman

Non-executive director and senior independent director (64)

Appointed to the board: 2011

Skills and experience

Keith has many years' experience in the rail and bus service industries, including 15 years with the Go-Ahead Group plc where he spent five years as chief executive. He was chairman of the Association of Train Operating Companies and a member of the British Transport Police Authority. He is a fellow of the Chartered Institute of Logistics and Transport and a fellow of the Institution of Railway Operators. Keith is also a non-executive director of Network Rail Consulting Limited.

Current external appointments

Chairman of Bristol Water plc; non-executive director of Interserve Plc and London Transport Museum.

Committee membership

Audit and risk committee; chair of nomination and corporate governance committee; chair of policy and performance committee.

12 Michael O'Higgins

Non-executive director (59)

Appointed to the board: 2012

Skills and experience

Michael has significant public sector and commercial experience. Michael has been chairman of the Pensions Regulator and the Audit Commission, managing partner at PA Consulting Group and a partner at PriceWaterhouse. He was also chair of Centrepoint, the youth homelessness charity. He has held visiting academic appointments at the London School of Economics, the Australian National University and Harvard University.

Current external appointments

Chairman of NHS Confederation, Investec Structured Products Calculus VCT plc; non-executive director of HM Treasury.

Committee membership

Audit and risk committee; chair of remuneration committee.

13 Bridget Rosewell

Non-executive director (62)

Appointed to the board: 2011

Skills and experience

Bridget is an economist and senior partner of Volterra producing economic analysis across a range of sectors. Bridget is also chair of the risk committee for Ulster Bank. Past roles have included being chief economist and chief economic adviser to the Greater London Authority, executive chairman of Business Strategies Ltd, which was subsequently sold to Experian. She was also a founder of Oxford Economic Research Associates and previously held a position as an economics adviser to Chancellor Kenneth Clarke. She was also previously a non-executive director of the Department of Work and Pensions and Britannia Building Society. Bridget was awarded an OBE in 2013 for services to the economy.

Current external appointments

Senior partner Volterra; non-executive director of Ulster Bank; member of with-profits committee Royal London Mutual Insurance Society Limited, director of ESPY Analytics Limited.

Committee membership

Chair of audit and risk committee; policy and performance committee; treasury committee.

14 Suzanne Wise

Group general counsel and company secretary

Skills and experience

Suzanne is responsible for the Legal Services function and is a member of the group executive. Suzanne has extensive in-house legal and corporate governance experience gained within the listed environment having joined the company from Premier Foods plc where she held the position of general counsel and company secretary. Prior to Premier Foods plc she was head of Legal at Gallaher Group plc. In her early career she was a solicitor in private practice.

Responsibilities

Suzanne leads the Legal Services function which provides professional advice and guidance and sets the strategy, tone and direction in the areas of legal, company secretariat, transparency and business ethics. Legal Services provides the company with an effective corporate governance framework, leads the organisation in the appreciation and mitigation of legal risk, builds the company's legal capability and expertise and drives greater transparency and appreciation of business ethics and legal compliance.

Graham Eccles stepped down as a non executive director on 18 July 2013.

David Higgins, former chief executive stepped down from the board on 28 February 2014.

Simon Kirby stepped down as managing director, Infrastructure Projects on 18 May 2014.

Corporate governance report

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Corporate governance report

We have bold plans. Delivering them requires high standards of business culture not only in the boardroom but across the whole organisation.

Compliance with the provisions of the UK Corporate Governance Code

The board considers that the company has complied with the UK Corporate Governance Code (the Code) throughout the year.

Leadership

Role of the board

The board leads the company and is responsible for the successful delivery of CP5 and beyond. The board governs the strategic direction of the business and supervises its operational management within the financial and regulatory targets set by Government. As the company operates as a commercial business, the directors are responsible for financial performance, determining the risk appetite and establishing appropriate controls for the company. Business culture is critical for the company's success and the board recognises the importance of acting in line with the behaviours it has set. Network Rail's impact is far reaching, so while the board is directly accountable to members, it has a responsibility to other stakeholders when making decisions.

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

- The group's overall strategy, business plan and annual operating budget
- The annual and half-yearly financial statements of the company
- Material changes to the network licence
- Key pension matters
- Adequacy of internal control systems
- Major capital investments and expenditure
- Risk management strategy
- The appointment of directors and the company secretary
- The performance reviews of the board and its committees.

+ The matters reserved for the board are at networkrail.co.uk/BoardMatters

Board allocation of time

Board meetings focus on safety, health and environment, strategy, business operations, finance and investment matters and governance and risk management.

There is an agreed schedule of items to be brought to the board throughout the year.

Board meeting frequency

The board has adopted a timetable of eight scheduled board meetings each year with additional meetings being arranged where necessary. Whilst board meetings are generally held at the company's head office in London, during 2014 the board held a meeting at the company's national centre in Milton Keynes, Transport for London's offices and in Cardiff. This provided the directors the opportunity to visit the sites and meet a cross-section of employees and community stakeholders.

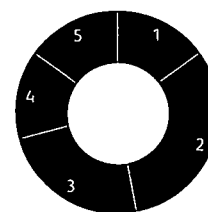
Attendance by directors at board meetings during 2014 is set out in the table on page 55.

Publication of board minutes

As part of the company's transparency commitment, minutes of board meetings are available at networkrail.co.uk/transparency/datasets

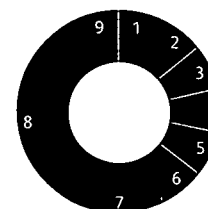
The board leads the company and is responsible for the successful delivery of CP5 and beyond

Board allocation of time in 2014



1. Safety, health and environment	15%
2. Strategy	32%
3. Business operations	24%
4. Finance and investment	14%
5. Governance and risk	15%

The board's industry background as at 31 March 2014



1. Advisory services	7%
2. Aerospace	7%
3. Airports	7%
4. Automotive	7%
5. Banking	7%
6. Public sector	7%
7. Oil and gas	15%
8. Railway	36%
9. Regulation	7%

Board membership

Biographies of the directors are on pages 48 to 50.

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

- Mark Carne was appointed chief executive designate on 6 January 2014 becoming chief executive on 24 February 2014. David Higgins, former chief executive, stepped down from the board on 28 February 2014.
- Chris Gibb was appointed as a non-executive director on 12 November 2013.
- Graham Eccles stepped down as a non-executive director after the AGM on 18 July 2013.
- Simon Kirby stepped down as managing director, Infrastructure Projects on 18 May 2014.

Mark Carne's and Chris Gibb's appointment will be put to members for approval at the annual general meeting (AGM) on 18 July 2014. Details of the selection process for new directors are in the nomination and corporate governance report on pages 62 to 63.

Mike Firth, Lawrie Haynes and Keith Ludeman have announced that they will not be standing for re-election at this year's AGM. The nomination and corporate governance committee has commenced the selection process, on behalf of the board, to find suitable successors.

Director election/re-election

All the directors will be presented to members for election or re-election at the AGM except those who have announced their intention to resign. All directors that are subject to election or re-election continue to perform effectively and demonstrate commitment to their respective roles.

Directors' conflicts of interests

Directors have a continuing obligation to update the board on any changes to their potential or actual conflicts that they may have with the company with immediate effect. Relevant disclosure is considered at the beginning of each board meeting and directors are also required to complete an annual disclosure of conflicts using a questionnaire. Where a director has a potential or actual conflict of interest, procedures are in place to prevent the director from being involved in any decision-making process in relation to that interest.

It is appropriate to disclose that the reimbursement of expenses and cost of secretarial services for Richard Parry-Jones was made by payment of £32,403.02 (2013: £16,956.62) to RPJ Consulting Services Limited in which he has a material interest.

Board committees

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

- Safety, health and environment committee
- Nomination and corporate governance committee
- Policy and performance committee
- Treasury committee
- Audit and risk committee
- Remuneration committee.

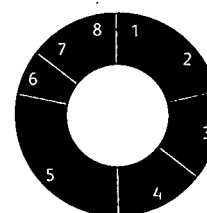
After each committee meeting, the committee chairmen update the board at its next meeting on how the committees have discharged their responsibilities.

Details of these committees and their activities during the year are set out from page 60.



The committees' terms of reference are at networkrail.co.uk/ToR

The board's professional background as at 31 March 2014



1. Customer service	7%
2. Economist	15%
3. Engineering	15%
4. Finance	15%
5. Operations	28%
6. Projects	7%
7. Policy	7%
8. Safety	7%

Length of tenure of directors on the board as at 31 March 2014



0-3 years	7
4-6 years	6
7-9 years	1

Board composition as at 31 March 2014




Chairman*	1
Executive directors	5
Independent non-executive directors	8

*Independent on appointment

Corporate governance report continued

Role of the chairman

The chairman leads the board and is responsible for its effective functioning and promoting the highest standards of corporate governance. The chairman encourages all directors to actively contribute to board meetings and sets the conditions for constructive relations between the executive directors and non-executive directors. He represents the company at its highest level and works with the chief executive to develop strategic relationships with major customers and political leaders.

 A statement of responsibility for the role of the chairman is at networkrail.co.uk/ChairmansRole


Chairman's time commitment

The chairman's contractual commitment to the company is two days per week. The chairman's main interests outside the company are set out in his biographical details on page 49. The chairman has confirmed that the performance of his outside responsibilities continue to be achieved without detriment to his duties to the company and he anticipates this will remain so going forward.

Role of the chief executive

The chief executive is responsible for the leadership and management of the company within the strategy and business plan agreed by the board. He keeps the board informed as to the performance of the company and brings to its attention all matters that materially affect, or are capable of materially affecting the achievement of the company's strategy. The chief executive provides clear and visible leadership in business conduct and promotes the requirement that all executive leaders are exemplars of the company's values.

The chief executive chairs the executive committee which comprises of the executive directors and a number of other senior executives. It manages the functions of the business and implements the operational and financial objectives within limits set by the board.


 A statement of responsibility for the role of the chief executive is at networkrail.co.uk/CERole

Role of the executive directors

The chief executive and executive directors have specific responsibilities for key parts of the business. They provide the non-executive directors with a wider and more immediate view of operational issues and prevent views and perception from becoming dominated by a single executive voice. Details of the executive directors' responsibilities are in the board biographies on pages 48 to 50.

Role of the senior independent director


The senior independent director is available to members if they have concerns where contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate. The senior independent director acts as a sounding board for the chairman and serves as an intermediary for the other directors when necessary. The senior independent director is responsible for the chairman's performance review.

 A statement of responsibility for the role of the senior independent director is at networkrail.co.uk/IDRole

Role of the non-executive directors

The non-executive directors combine broad business and commercial experience from the rail and other industry sectors. They bring independence, external skills and challenge. This is critical for providing assurance that the executive directors are exercising good judgement in delivery of strategy and decision-making.

Information on the skills and experience of the non-executive directors can be found in the board biographies on pages 48 to 50.

 A statement of responsibility for the role of the non-executive directors is available at networkrail.co.uk/NERole

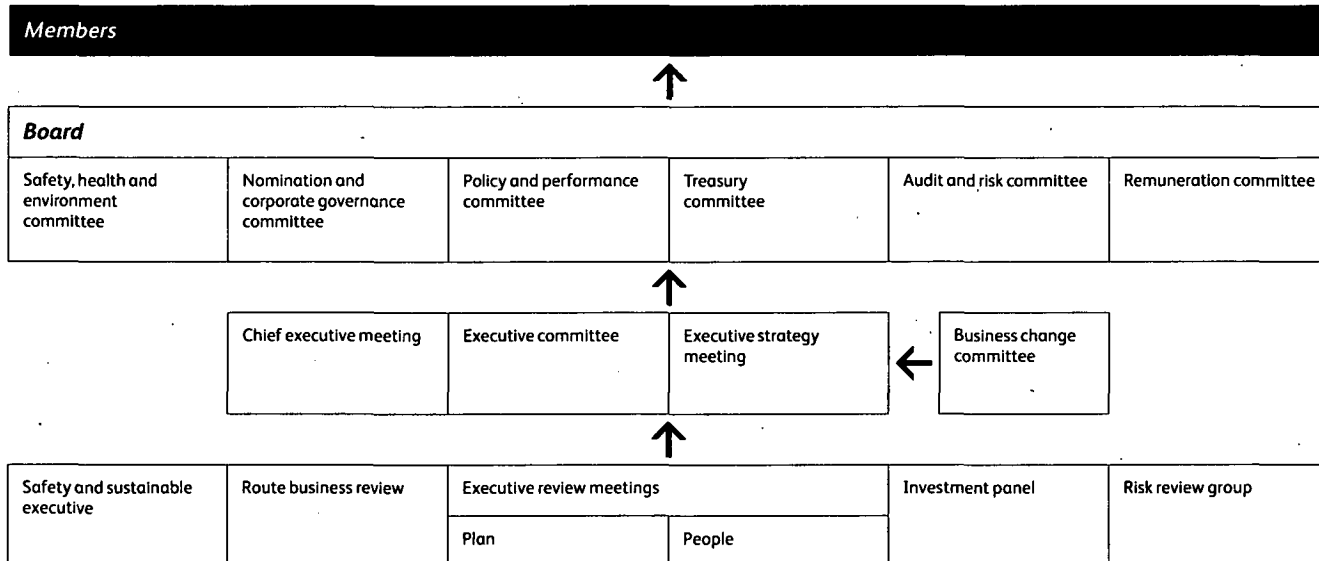
The board considers that each of the non-executive directors is independent of the company. With regard to the guidelines on the meaning of 'independence' as set out in the Code, it is appropriate to disclose that:

- Chris Gibb and Graham Eccles (who stepped down from the board on 18 July 2013) receive a pension from the Railway Pension Scheme (RPS). Over 150 companies from the rail industry participate in RPS. The scheme is run by independent trust managers, with trustees drawn from across the membership of the scheme. Given this structure, the board considers that membership to RPS does not affect director independence, as Network Rail is only one of many contributing companies to RPS
- Mike Firth has been a non-executive director for nine years. Whilst the board considers that Mike continues to remain independent from the company Mike has decided not to stand for re-election as a director at this year's AGM.

Non-executive director meetings

The chairman holds regular scheduled meetings with the non-executive directors without the executive directors present to discuss the performance of the company under the executive leadership. In 2014 the non-executive directors met separately from the executive directors on two occasions.

Summary board and committees structure



Attendance at board and committee meetings during the year

	Board	Safety, health and environment	Nomination and corporate governance	Policy and performance	Treasury	Audit and risk	Remuneration
Number of meetings held	8	5	2	5	4	4	9
Attendance¹							
Richard Parry-Jones	8/8	4/5	2/2	5/5	4/4	N/A	9/9
Mark Carne ²	2/2	N/A	N/A	N/A	N/A	N/A	N/A
David Higgins ³	8/8	N/A	N/A	N/A	N/A	N/A	N/A
Patrick Butcher	7/8	N/A	N/A	N/A	N/A	N/A	N/A
Robin Gisby	8/8	N/A	N/A	N/A	N/A	N/A	N/A
Simon Kirby ⁴	8/8	N/A	N/A	N/A	N/A	N/A	N/A
Paul Plummer	8/8	N/A	N/A	N/A	N/A	N/A	N/A
Malcolm Brinded	8/8	5/5	N/A	N/A	N/A	N/A	N/A
Graham Eccles ⁵	4/4	1/2	1/1	1/1	N/A	N/A	3/3
Mike Firth	8/8	N/A	N/A	N/A	4/4	4/4	9/9
Chris Gibb ⁶	3/3	1/1	N/A	2/2	N/A	N/A	N/A
Lawrie Haynes ⁷	7/8	2/2	N/A	0/1	N/A	2/4	N/A
Janis Kong	8/8	4/5	2/2	N/A	N/A	3/4	N/A
Keith Ludeman	8/8	N/A	2/2	5/5	N/A	4/4	N/A
Michael O'Higgins	8/8	N/A	N/A	N/A	N/A	4/4	9/9
Bridget Rosewell	8/8	N/A	N/A	5/5	3/4	4/4	N/A

Notes

- All directors are expected to attend board and those committee meetings of which they are members. Processes are in place for minimising directors' non-attendance. The occasions where circumstances prevented a director from attending a meeting were as a result of illness and existing conflicting diary commitments. Where a director is unable to attend, a meeting, the director will be provided with the papers and given the opportunity to discuss his comments with the chairman prior to the meeting.
- Mark Carne was appointed to the board on 6 January 2014
- David Higgins stepped down from the board on 28 February 2014
- Simon Kirby stepped down from the board on 18 May 2014
- Graham Eccles stepped down from the board on 18 July 2013
- Chris Gibb was appointed to the board on 12 November 2013
- Lawrie Haynes stepped down from the policy and performance committee and safety, health and environment committee on 18 July 2013

Corporate governance report continued

Directors' pay

Details of the directors' service contracts, letters of appointment and remuneration can be found in the remuneration report on pages 69 to 92.

Directors' and officers' liability insurance

The company maintains directors' and officers' liability insurance which provides appropriate cover for legal action brought against directors.

No directors were indemnified during the year.

Board diversity

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

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

- In seeking candidates for appointment to the board, the nomination and corporate governance committee will only engage the services of search consultants who have open and inclusive recruitment processes that draw from an appropriately diverse pool of candidates
- It will have an aspirational target of at least 25 per cent of the non-executive directors being women by 2015
- Through its regular reviews of management succession planning it will oversee the effectiveness of the actions being taken by management to ensure that the composition of the executive leadership team reflects the entirety of the management talent pool available within the company and the wider market.

Diversity is considered important at all levels below board, page 46 provides further detail.

Board updates – business developments

Directors are encouraged to update their skills, knowledge and familiarity with the group through ongoing participation at board and committee meetings, meetings with senior managers and other employees. During the year, the board attended the offices of Transport for London (TfL) where they received a briefing from Terry Morgan, chairman of Crossrail. The board engaged with TfL's senior management and visited the London Underground and Surface Transport control centres to consider TfL's perspective on operations.

In 2014 the chairman arranged two stakeholder events. The board met a wide range of industry representatives to further enhance the directors' understanding of differing stakeholder needs and concerns.

Board updates – governance matters

The board considers that keeping up to date with developments in corporate governance is important for its effective functioning. The group general counsel provides briefings on regulatory and governance-related matters tailored for the company's business model. During the year the focus of these briefings has been on: business ethics, board effectiveness with focus on the provision of board information, and changes to annual reporting in relation to the Business Innovation and Skills' narrative and remuneration reporting regulations and the Financial Reporting Council's (FRC) auditing standards.

25%

The board has an aspirational target of at least 25 per cent of the non-executive directors being women by 2015.

Split of men to women non-executive directors* as at 31 March 2014



Men	78%
Women	22%

*Including the chairman

Split of men to women on the board as at 31 March 2014



Men	86%
Women	14%

Board and committee effectiveness

The nomination and corporate governance committee is charged by the board to review annually the performance of the board, its committees and individual directors.

IDDAS, who have no connection with the company, were appointed to conduct the 2014 board evaluation. This followed external reviews carried out by Deloitte LLP in 2011 and 2012 and an internal review in 2013.

The review was carried out against the FRC's framework on board effectiveness, and focused on the collective performance of the board and its committees, alongside the contribution, effectiveness and commitment of individual directors. The evaluation process can be summarised as:

- Performance against the strategic priorities and expectations for the organisation
- Structural performance against the Code

- Functional effectiveness of the board and committees, including the effectiveness of their structures and processes
- Effectiveness of people, relationships and boardroom dynamics.

The review was comprised of the following:

- One-to-one interviews with all directors, using a structured questionnaire
- IDDAS observing a board meeting and committee meetings
- Review of board and committee documentation.

IDDAS compiled a report of the results of the review and presented their findings to the board.

The review found that the board is broadly effective and cohesive with extraordinarily committed directors, who devote an unusually high level of time, energy and passion in discharging their duties.

The key challenges facing the board were:

- The amount of time being spent on remuneration policy with a recognition that this time could be more effectively utilised
- The quality of information being presented to the board which required further purpose and clarity
- The need to step out of operational detail and spend a greater percentage of time on strategic matters.

A board effectiveness plan has been developed and is being implemented to address the findings of the report.

Board induction programme

A typical director's induction programme in 2014

Operational site visits:

- **Project visit**
- **Station visit**
with station manager
- **Route visit**
to meet route control, level crossing, station and training centre teams.

Internal meetings held with:

- Each non-executive director
- Each executive committee member.

External meetings held with:

- Chair of the Office of Rail Regulation
- Director General, Department for Transport.

Briefing with group general counsel on:

- Board level governance
- Directors' duties
- Members
- Management incentive plan
- Major litigation.

Induction with safety and sustainable development director on:

- Safety-related matters
- Safety management system
- Directors' responsibilities.

Any other site visit/meeting considered pertinent for fulfilling the role

Corporate governance report continued

Engaging with members

Composition of members

Members perform a similar role to institutional investors in a listed public limited company, except as a company limited by guarantee, members do not have any financial interest in the company.

Members hold the board to account for its management of the company by:

- Monitoring the performance of the board against high standards of corporate governance and regulatory, operational and financial targets
- Engaging with the board, in an informed and objective manner, on their performance
- Seeking assurance that governance procedures are designed to facilitate the delivery of strategic objectives
- Entering into dialogue on matters that are an immediate subject of votes at general meetings.

As at 31 March 2014, the company had 41 members and the Department for Transport, as a special member.

+ Further details of the role and the biographies of the members are at networkrail.co.uk/BoardBiogs

Appointment of members

Members are recruited on an annual basis and are currently appointed for a three-year term. Members are appointed in accordance with the membership policy, which is overseen by the membership selection panel and supported by Harvey Nash (a recruitment specialist).

On 26 November 2013 11 new public members were appointed, six were re-elected and 12 retired.

+ Further details of the selection and recruitment process can be found at networkrail.co.uk/SelectionProcess

Members' engagement

Member relations is managed by the group general counsel and overseen by the chairman. The chairman regularly updates the board at its meetings on the company's engagement with members.

Split of men to women public members as at 31 March 2014



Men	78%
Women	22%

A snapshot of resources and opportunities available to members during the year

Meetings <ul style="list-style-type: none"> • Half-yearly meeting to consider the half-year results • Five meetings to update members on governance, remuneration, safety and performance matters • Focussed member engagement groups providing members the opportunity to receive more in-depth briefings from the board and senior managers in five key strategic areas – safety, people, future, performance and finance and risk • Two meetings with the Office of Rail Regulation (ORR) to consider the regulator's view on the company's performance. 	Publications <ul style="list-style-type: none"> • Chairman's quarterly governance letter detailing the board's strategic and governance developments • Network Rail and ORR publications and press releases • Railway periodicals.
Dialogue <ul style="list-style-type: none"> • Scrutiny sessions with the chairman and non-executive directors to engage on the methods used for holding the executives account • Site visits to meet our operational teams – this included a tour of the Birmingham New Street Development, a visit to the Milton Keynes National Centre and a briefing with the ORBIS function (Offering Rail Better Information Services). 	Support <ul style="list-style-type: none"> • Dedicated members' support team (who operate within a service level agreement) • Members' website for secure document storage and correspondence amongst members • Two day residential induction for new members to enhance their understanding of the company and their role.

The AGM

The AGM provides an opportunity for the board to engage with members. Constructive board-member dialogue is facilitated throughout the event. The chief executive and group finance director present to members on past-year performance and future plans for the company. Members are able to submit written questions in advance of the meeting, enabling the directors to prepare a comprehensive response.

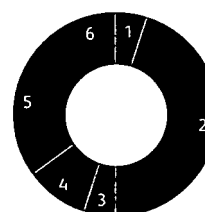
Above: Richard Parry-Jones welcoming the members to the 2013 AGM

The formal business of the AGM is considered by single separate resolutions. Poll voting is adopted for all resolutions with members having the option to vote either for or against a resolution, or to withhold their vote. Final voting figures are announced to London Stock Exchange.

The notice of the AGM and the annual report and accounts are mailed to members with the aim of arriving at least 20 business days before the date of the meeting.

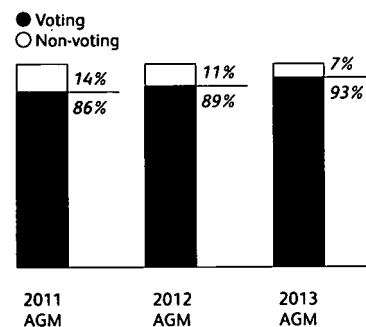
The next AGM will be held on 18 July 2014.

Allocation of members' events during 2014



1. AGM	1
2. Engagement group meetings	9
3. Half-year meeting	1
4. Meeting with Office of Rail Regulation	2
5. Members' workshop	5
6. Site visits	2

Members voting at AGMs over a three-year period



Corporate governance report continued

Safety, health and environment committee report

Committee members

Malcolm Brinded
(Chairman from July 2013) November 2010

Chris Gibb November 2013
Janis Kong January 2010
Richard Parry-Jones April 2013

Previous members:

Lawrie Haynes
(Chairman from September 2010)
January 2010 – July 2013

Graham Eccles*
February 2010 – July 2013

Malcolm Brinded

Chairman, safety, health and
environment committee

Committee attendees

The chief executive, managing director, Network Operations, managing director, Infrastructure Projects, group asset management director, the safety and sustainable development director and group general counsel attend meetings by invitation.

Mick Cash, senior assistant general secretary of the RMT attends committee meetings. Mick participates in, and introduces topics for discussion. This aids scrutiny and challenge and enhances transparency of the work of the committee.

During the year, representatives from the Samaritans attended a meeting to provide a progress update on the Suicide Reduction Programme and Ian Prosser, head of safety for the Office of Rail Regulation, attended a meeting to present the regulator's view on the company's safety performance.

Number of meetings held during the year

The committee met five times during the year. During the year, the committee visited London Bridge to observe the safety measures being implemented during the redevelopment of the station.

Role of the committee

The committee's role is to monitor the integrity of the methods of discharge of the safety, health and environmental responsibilities of the company and to satisfy itself as to the adequacy and effectiveness of the safety, health and environment policies and strategies within the group.

The committee's responsibilities include:

- Considering significant corporate and individual safety, health and environment risks and whether management is managing these effectively
- Reviewing the structure and adequacy of safety, health and environment managerial committees within the company
- Reviewing the scope and results of any safety, health and environment audits, and their effectiveness
- Considering the major findings of internal and external investigations and management's response.

In respect of all of the above, where necessary making recommendations to the board.

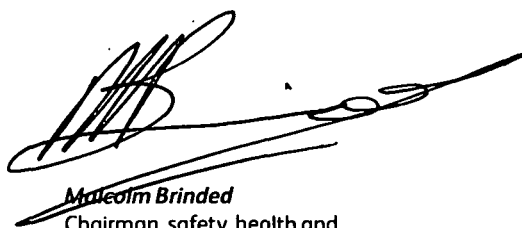
*Graham Eccles stepped down from the board on 18 July 2013.

Principal activities of the committee during the year

A snapshot of some of the matters considered by the committee during the year:

- Periodic reports on safety, health and environmental performance of the company
- Learnings derived from incidents and near misses on the company's network and from an international perspective
- Workforce safety performance, the development of the 10-point safety plan and its appropriateness and adequacy
- Deep dive strategic risk reviews held on earthworks, level crossings, structures and track
- The development of the company's sustainable development strategy and the group's approach to community and social impact activities, climate change and energy efficiency in relation to this strategy
- The company's health and well-being strategy and the long-term commitment to improving occupational health management
- Progress of the safety culture change programme and next steps:

Overall, the committee believes that the company has developed comprehensive programmes to address both major train accident risk and workforce safety. Steady progress is being made in improving the analysis and insight into major accident risks, and in implementing associated risk reduction measures. On workforce safety, there is still much to do to fully embed the programmes and drive the culture change that should together achieve the significant performance that is targeted during CP5.



Malcolm Brinded
Chairman, safety, health and environment committee

The committee's role is to monitor the integrity of the methods of discharge of the safety, health and environment policies and strategies within the group.

Corporate governance report continued

Nomination and corporate governance committee report

Committee members

Keith Ludeman
(Chairman) July 2012

Janis Kong July 2010
Richard Parry-Jones April 2013

Previous members:
Graham Eccles*
July 2010 – July 2013

Keith Ludeman

Chairman, nomination and corporate
governance committee

Committee attendees

The chief executive, director, Human
Resources and group general counsel
attend certain meetings by invitation.

Number of meetings held during the year

Although the committee only met formally
two times during the year, the members of
the committee met a number of times in
respect of the appointment of a new chief
executive and non-executive director.

Role of the committee

The committee is responsible for the
board evaluation process and reviews
regularly the size, structure and
composition of the board and its
committees and makes recommendations
to the board on any adjustments deemed
necessary and feasible. The committee
identifies and nominates candidates for
appointment to the board and satisfies
itself that appropriate succession
planning is in place.

Principal activities of the committee during the year

Recruitment of a chief executive director and non-executive director

Following David Higgins' and Graham
Eccles' decision to step down as chief
executive and non-executive director
respectively, the committee was tasked
with identifying and nominating suitable
candidates for the board to approve.

Recruitment of a chief executive

The committee prepared a person
specification for the role bearing in mind
the leadership requirements for CP5 and
the need for a strong understanding in
engineering.

Following a competitive tender process,
Spencer Stuart were appointed to identify
candidates against this specification.
Spencer Stuart have no connection with
the company and are signatories to the
Voluntary Code of Conduct for Executive
Search Firms. The position was also
advertised internally and externally.

Candidates from a wide range of relevant
industry sectors were identified and
interviewed by members of the committee.

Having fully tested the market, the
committee recommended to the board
the appointment of Mark Carne as chief
executive and this was approved by a
committee of the board in September 2013.

Recruitment of a non-executive director

The committee prepared a person
specification for the role being mindful of
the network licence requirement that two
of the company's non-executive directors
must have substantial experience of
working in the rail industry.

Odgers Berndtson, who have no
connection with the company and are
signatories to the Voluntary Code of
Conduct for Executive Search Firms, were
appointed to identify candidates against
this specification and the position was
advertised externally.

Candidates were identified and
interviewed by members of the committee.

*Graham Eccles stepped down from the board on 18 July 2013.

The committee recommended to the board the appointment of Chris Gibb as a non-executive director and this was approved by the board at its September 2013 meeting.

Mark and Chris will be presented to members for election at the company's AGM in 2014. The committee was mindful of the benefits of board diversity throughout the selection process and it is considered that both Mark's and Chris' expertise adds strong and different dimensions of challenge to the board.

Mark and Chris were provided with tailored induction programmes suitable for their role. Page 57 provides further detail of a typical induction plan.

Board evaluation

The committee, on behalf of the board, is responsible for the evaluation process of the board, its committees and individual directors. The committee determined the scope and approach of the 2014 review. IDDAS, who have no connection with the company, were appointed to conduct the evaluation and the committee oversaw this process. Detail of the process and the outcome of the review is presented on page 57.

Succession planning

The committee received progress reports from senior management on the succession planning process with particular focus on senior key roles in the business. The committee recognises that effective talent management programmes and the enhancement of diversity and inclusion across all levels of the organisation is essential for the delivery of the company's long-term objectives.



Keith Ludeman

Chairman, nomination and corporate governance committee

Recruitment of a new director

Person specification for the role

Taking into account:

- Feedback from key stakeholders
- Skills and experience already on the board
- The Code
- The network licence
- The articles of association of the company.

Appointment of search consultant

- No connection with the company
- Signatories to Voluntary Code of Conduct for Executive Search Firms

External advertisement

Review of candidates (long-list)
by committee members

Capability interviews (short-list)
by committee members

Identification of candidate
Committee recommendation to the board

Board approval
of appointment

Member approval
of appointment

Corporate governance report continued

Policy and performance committee report

Committee members

Keith Ludeman July 2011
(Chairman from July 2012)

Chris Gibb November 2013
Richard Parry-Jones April 2013
Bridget Rosewell January 2011
(Chairman to July 2012)

Previous members:
Graham Eccles*
March 2010 – July 2013

Lawrie Haynes
March 2010 – July 2013

Keith Ludeman

Chairman, policy and performance committee

Committee attendees

The chief executive, group strategy director, managing director, Network Operations, group asset management director and group general counsel attend by invitation.

Number of meetings held during the year

The committee met five times during the year. An additional briefing was arranged for the committee on the franchising process with Peter Wilkinson, the franchising director from the Department for Transport.

Role of the committee

The committee monitors progress in delivery of the regulatory outputs reflected in the delivery plans and against other targets agreed by the company. The focus is on performance, capability, capacity, availability, customer satisfaction (with particular emphasis on the company's customers and their customers) and more general compliance with key regulatory obligations. The committee also monitors the company's stewardship of the railway infrastructure, covering the planning and delivery of maintenance and renewals.

Principal activities of the committee discussed during the year

A snapshot of some of the matters considered by the committee during the year:

- Current train performance and the rationale for falling short of regulatory outputs with focus on the need to understand the root causes of poor performance
- Progress against the CP4 delivery plan, compliance with other regulatory obligations and reform of the industry regulatory and contractual framework
- The periodic review process and dialogue with Office of Rail Regulation and other key stakeholders
- The results of stakeholder surveys – customer and supplier perception
- Business case studies, including the Sussex route, the Wessex alliance and the West Coast mainline.



Keith Ludeman
Chairman, policy and performance committee

*Graham Eccles stepped down from the board on 18 July 2013.

Corporate governance report continued

Treasury committee report

Committee members

Mike Firth (Chairman)	December 2004
Richard Parry-Jones	April 2013
Bridget Rosewell	July 2012

Mike Firth
Chairman, treasury committee

Committee attendees

The group finance director, group treasurer, head of treasury operations and group general counsel attend meetings by invitation.

Number of meetings held during the year

The committee met four times during the year.

Role of the committee

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

Principal activities of the committee during the year

The committee considers on a routine basis:

- The treasury risk register
- Debt issuance and investments
- Interest-rate hedging
- The group's treasury policy.

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

- The progress on the proposed financial framework for CPS
- The new European derivative regulations (EMIR) and the implications for the company
- The company's index-linked debt programme and index-linked issuance strategy.

The executive and group Treasury have engaged with the Government, HM Treasury and Office of Rail Regulation in respect of the Office of National Statistics' decision to reclassify the company as a Central Government Body in the UK National Accounts. The committee has been kept informed of developments and considered the implications for future funding. The impact of the reclassification will continue to remain a focus for the committee for the foreseeable future.



Mike Firth
Chairman, treasury committee

Corporate governance report continued

Audit and risk committee report

Committee members

Bridget Rosewell* July 2012
(Chairman)

Mike Firth** December 2004
(Chairman January 2006 – July 2012)

Lawrie Haynes November 2010
Janis Kong January 2010
Keith Ludeman July 2011
Michael O'Higgins February 2013

Bridget Rosewell

Chairman, audit and risk committee

Committee attendees

The chairman, chief executive, group finance director, director, Risk and Assurance, safety and sustainable development director and group general counsel attend meetings of the committee by invitation. Two representatives from the independent auditors also attend each meeting and periodically meet with the committee members without executive management present.

Number of meetings held during the year
The committee met four times during the year.

Role of the committee

The committee monitors the integrity of the financial reporting and the audit process and monitors internal control systems including risk management, regulation and compliance. The committee makes recommendations to the board on the level of risk appetite acceptable to the company and oversees the process for the identification and management of risk. The committee is responsible for maintaining an appropriate relationship with the independent auditors and the Internal Audit function. The committee reviews the policy and procedures whereby employees can raise, in confidence, concerns about possible improprieties.

Principal activities of the committee during the year

A snapshot of some of the matters considered by the committee during the year:

Internal controls and risk management

- Risk management reports, identifying high-level risks and the status of mitigation, current risk profile, changes to the profile during the year and the progress that has been undertaken in relation to the several strategic risks
- Deep-dive risk reviews and mitigating actions on a number of the company's key risks including business continuity management, cyber security and the CP5 business plan
- The adjustments by the regulator for out- and under-performance
- The effectiveness of the implementation of the company's code of business ethics.

Financial reporting

- The company's approach and processes for disclosing information to PwC and the related statement in the 2014 financial statements
- PwC's approach and scope of the audit work and the findings of their work
- The 2013 financial statements and the 2013 half-yearly report with focus on the reporting judgements contained within them and the basis for preparing the accounts on a going concern basis.

Internal audit

- The internal audit programme for 2015
- The output from, and considered progress against, the internal audit programme
- Implementation of actions from internal audits, and outstanding actions.

* Bridget Rosewell is current chair of the risk committee of Ulster Bank. She was previously chair of the audit committees for Britannia Building Society and the Department for Work and Pensions.

** Mike Firth has a strong and lengthy financial background, including experience of chairing listed company's audit committees. He is also a fellow of the ifs School of Finance and an associate of the Chartered Institute of Bankers.

Significant judgements, key assumptions and estimates

With the support of the independent auditors, the committee assessed whether suitable accounting policies had

been adopted, whether management had made appropriate estimates and judgements and disclosures were balanced and fair. The main areas of focus during the year are set out below.

<i>Matters considered</i>	<i>How the committee addressed these judgements</i>
<p>Valuation of railway network and compliance with regulatory requirements</p> <p>The revaluation model used to measure the value of the railway network consists of a number of estimates and judgements made both by the company and the Office of Rail Regulation (for example anticipated financial and operational outperformance in the control period). With the end of CP4, the level of judgements and estimates in the railway network valuation are particularly prevalent.</p>	<p>Detailed reports from management were considered by the committee and the methodology applied to the revaluation model was also reviewed.</p> <p>Discussions have been held with Arup, the regulator's independent reporter on the findings of their work in respect of efficiency measures in CP4 and its impact on the railway network valuation.</p> <p>The committee also discussed with management and the independent auditors:</p> <ul style="list-style-type: none"> • The reasonableness of key judgements and estimates in respect of the close-out of CP4 and the implications of CP5 • The adequacy of the disclosures in the annual report and accounts around the valuation process and the related assumptions and judgements.
<p>Risk of management override of internal controls</p>	<p>Reports on management's approach to implementing, operating and monitoring the system of internal control are considered by the committee on a regular basis. The committee considered a letter of responsibility from the chief executive regarding the standard of internal controls and integrity that has prevailed in the business during the financial year.</p> <p>The independent auditors have also focused attention on this area and provided reporting to the committee on this matter.</p>
<p>Valuation of investment properties</p> <p>Investment properties are stated at fair value. The valuations are based on assumptions and estimates that require judgement.</p>	<p>The independent auditors reported to the committee on this matter, following discussion with management of the methodology and approach to the valuations with external valuation specialists and management.</p>
<p>Provisions and claims</p> <p>The group is subject to a number of claims in respect of incidents, investigations, project spend, contractor claims, commercial claims or claims in respect of performance.</p>	<p>The independent auditors reported to the committee on this matter, following discussion with management of any significant claims, the judgements involved and assumptions relating to the provisions in the balance sheet.</p>
<p>Pension assumptions</p> <p>The group operates defined benefit and defined contribution pension schemes. Valuation of these schemes is dependent on certain key assumptions and complex calculations. External actuaries are engaged to assist in advising on key assumptions and determining the value of the pension obligations.</p>	<p>The committee discussed the key assumptions, including the degree to which these were supported by professional advice from the actuaries. The independent auditors also focused attention on this area and provided reporting to the committee on this matter, following consultation with their own actuarial experts.</p>

Corporate governance report continued

Audit and risk committee report

Role of internal audit

The company has an independent Internal Audit function whose primary role is to provide objective and independent assurance regarding the adequacy of the group's internal control framework and compliance with policies, laws and regulations.

The work of Internal Audit is focused on the areas of priority as identified by risk and materiality analysis and is in accordance with an annual audit plan which is approved by the committee.

The committee receives regular reports on audit findings from the director, Risk and Assurance, who has direct access to the chairman of the committee. Recommendations to improve the internal control framework are reported to the committee through this process.

Independent auditors' objectivity and independence

The committee has put in place safeguards to protect independent auditors' objectivity and independence.

It has established a policy whereby employment of the independent auditors on work for the company is prohibited, other than for audit services or tax consulting services, without prior approval by the committee. The committee is responsible for the oversight of compliance with the policy and considers the infrequent requests to use the independent auditors for non-audit work.

In 2014 the fee for audit services was £0.7m and the fee for non-audit services was £nil.

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

The committee has responsibility for advising the board on the appointment, reappointment and the remuneration of the independent auditors. PwC have been the group's independent auditors since 2010, where they were recommended by the committee to the board for appointment, following a re-tender of external audit services.

In June 2014, the committee recommended to the board that PwC be presented for reappointment as the company's auditors at the AGM in July 2014. The board accepted the recommendation and the re-election of PwC as the group's independent auditors will be proposed at the 2014 AGM.

The committee's engagement with the independent auditors in respect to the 2014 financial statements

Prior to PwC commencing their audit of the 2014 annual financial results, the committee requested that the lead partner present to them their audit plan. The presentation covered PwC's proposed engagement with the company and how PwC have addressed prior feedback from both the committee and senior management. The presentation was critically considered by the committee and comments provided to the lead partner.

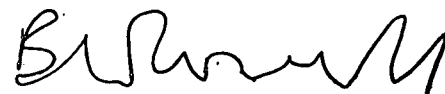
The committee's responsibilities for risk management

Whilst the ultimate responsibility for risk management rests with the board it delegates the more detailed oversight of risk management to the committee which reports its findings to the board.

Further details on the risk management and assurance process are on pages 26 to 29.

The requirement for the annual report to be fair, balanced and understandable

The committee acknowledges that, taken as a whole, the annual report and accounts need to be fair, balanced and understandable in order to provide the information necessary for members to assess the company's performance, business model and strategy. The committee advises the board on whether it believes that the annual report and accounts meet this requirement. In order for the committee to make this assessment it considers reports received from management during the year, monitoring financial performance and at year end in support of the financial statements. The committee also receives reports from the independent auditors on the findings of their annual audit. Formal review processes are in place to ensure the annual report and accounts are factually accurate.



Bridget Rosewell
Chairman, audit and risk committee

Directors' remuneration report

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Directors' remuneration report

This report has been prepared in accordance with the requirements of Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 ('the Regulations'). Some of the disclosures in these sections, where indicated, have been audited.

It is my pleasure to present my first directors' remuneration report as chairman of the Network Rail remuneration committee.

We recognise that executive pay is an important issue for our stakeholders and we remain committed to the highest standards of disclosure in this area. We have prepared the report in line with the requirements of the UK Corporate Governance Code. In line with the new regulations, the report is divided into two parts:

- The annual remuneration report provides a summary of the new CP5 remuneration framework which will apply for the 2015 financial year (pages 74-76), as well as explaining what was paid during 2014 and why (pages 78-82)
- The remuneration policy (pages 85-92) provides additional detail on the company's remuneration policies. Subject to member approval at the 2014 AGM, it will apply for three financial years and all remuneration decisions will need to be in line with the policies disclosed.

A remuneration framework to deliver CP5

As described in detail earlier in this report, our business faces significant challenges. These include major capital projects such as the redevelopment of Glasgow Queen Street and Reading stations, coping with increasing passenger journeys to 225 million by 2019, further reducing the cost of running the railway by 20 per cent, reducing level crossing risks by 25 per cent, reducing train accident risks by 50 per cent, delivering train punctuality with 92.5 per cent of trains arriving on time by 2019 and introducing the European Train Control System.

During the year, the committee has undertaken an extensive review of the executive remuneration framework to ensure that it most appropriately supports our vision to deliver the CP5 objectives.

The committee engaged widely with key stakeholders, particularly our members, during every stage of the review, openly sharing the information which informed the committee's decision making. The feedback from our members made a significant contribution to the shape of the new framework outlined below.

The committee identified four principles on which the CP5 remuneration framework should be based:

- **Simple.** The framework should be simple and transparent for all stakeholders to understand.
- **Competitive and fair.** Attracting and retaining leaders of the necessary calibre requires remuneration arrangements which are reasonable in the markets in which we compete for talent and which fairly reflect the market rate for the skills and experience of the individual. At the same time, we always remain cognisant of the need to ensure value for money for the funders of the railway, and to reflect the strong element of public interest in the business.
- **Performance and safety.** There should be a performance-related element of the package which rewards exceptional performance in the areas which are most important for our stakeholders. There should be no reward for failure. Safety of the workforce, passengers and the general public is at the heart of everything we do and must be reflected in the remuneration framework.
- **Aligned with employees.** Where possible, remuneration structures will be aligned across the organisation. All Network Rail employees continue to be eligible for incentive payments, determined using a consistent performance framework across the organisation.

The CP5 remuneration framework has been designed to meet these principles. It is described on pages 74 and 75 and in greater detail in the remuneration policy on pages 85-92. Key features and changes are:

Simplifying the framework	<ul style="list-style-type: none">• One incentive plan.• Measures cascaded consistently throughout the business• No further retention payments.
Aligned to performance and safety	<ul style="list-style-type: none">• A simple concept – based on performance for stakeholders each year and assessed annually• Safety now incorporated into the core measurement as well as being an important feature for remuneration committee discretion• Deferred for three years, with any payment subject to safety and sustainability obligations over that period.
Major reduction in bonuses	<ul style="list-style-type: none">• Major reduction in the maximum incentive opportunity, reflecting the strong element of public interest in the business• Maximum annual incentive opportunity reduced from a policy of 160 per cent of salary to 20 per cent of salary.
Salary increases aligned to employees	<ul style="list-style-type: none">• Over CP5, annual salary increases for executive directors will normally be in line with the typical increase for other employees• New starter salaries may need to be higher to retain our competitiveness to attract the appropriate talent.
Reduction in pension policy	<ul style="list-style-type: none">• Cash supplement for new appointments reduced from 30 per cent to 10 per cent of salary above the Network Rail earnings cap.

Context

Network Rail is large and complex and will continue to need talented leaders to deliver the long-term CP5 objectives outlined above, whilst remaining dedicated to ensuring the safety of our passengers, our workforce and the public on a daily basis.

During the year, we welcomed Mark Carne as our new chief executive. Mark's background with leading global companies, such as Shell and BG Group, demonstrate the type of skills and experiences which will be required to lead Network Rail through the challenges ahead. The committee firmly believes that our ability to secure leadership talent of the highest calibre is critical for Network Rail and is in the best interests of all stakeholders in the UK railway.

Network Rail operates as a commercial business. Remuneration needs to be credible when competing to secure top talent. At the same time, the committee also recognises that a key difference between Network Rail and other commercial organisations is that Network Rail is publicly funded and has a strong element of public interest including safety responsibilities.

Market data is one point of reference for the committee when making judgements on the right structure and level of executive directors' pay. As occurs for any role within Network Rail, the objective is to consider market data which is relevant to the role in question, reflects the skills and experience of the individual, the scope and responsibilities of the role, and the nature of the organisation. The committee takes the same approach for the executive directors.

In 2013, the committee undertook an extensive review of market data and positioning, using an approach developed transparently with members. We gathered market data from both large commercial organisations of a similar scale and which face similar operational challenges and from a number of public or quasi public organisations. The conclusion of the review was the principle, which was shared with members, that Network Rail is, and should be, positioned appropriately between these two markets, reflecting the scale of Network Rail's operations and the nature of its public obligations.

During 2014, in developing the framework for CP5, the committee further developed the principle above. The committee concluded, again taking into account input from our members, that the previous aggregate bonus opportunity was too high for Network Rail given the strong element of public interest in the business. As a result, under CP5 we will substantially reduce the maximum incentive opportunity from 160 per cent to 20 per cent of salary. The potential for executive directors to earn large bonuses is no longer sustainable in the public environment in which Network Rail operates.

At the same time, we need to ensure that the overall remuneration package can fairly reflect the skills and experience of the individual, is credible in the markets in which we compete for talent, and allows us to maintain our position between the two markets described above. The substantial reduction in potential incentives under the proposed arrangements means that there is a greater retention risk than previously existed. At this lower level of incentive opportunity it is likely that Network Rail may need to pay higher base salaries to attract new recruits to executive directors' roles in the organisation.

The rationale and the principles of our approach have been shared with members throughout the design process, and we have been encouraged by the support expressed thus far by our members.

2014 outcomes and events

The annual remuneration report (pages 77-85) describes the remuneration outcomes in respect of 2014 in detail. Key points include:

Management changes

In recent months, we have seen a number of changes to our leadership team. The committee determined the remuneration arrangements in each case, in line with our established policies and principles of best practice. There were no additional payments in respect of joining or leaving. To summarise the arrangements:

- Mark Carne joined the board on 6 January 2014 and succeeded David Higgins as chief executive on 24 February 2014. He was appointed on a remuneration package which in overall terms did not exceed that of his predecessor. He will participate in the company's pension arrangements on the same basis as other employees, and receive a pension allowance of 10 per cent of salary above the earnings cap in line with the new policy. He was not eligible to participate in the AIP for 2014. He also received a one off reimbursement of relocation costs of £25,000.
- Sir David Higgins stepped down from the Network Rail board on 28 February 2014 and Simon Kirby stepped down from the board on 18 May 2014. They did not receive any payment in lieu of notice or any other termination payment. To reflect their contribution to performance during the year, both are eligible for the AIP for 2014 as described below (for David Higgins the maximum opportunity is pro-rated for the period served as chief executive during the year). For both, awards under the 2012-15 LTIP will lapse in full.

Directors' remuneration report continued

Annual incentive plan (AIP) for 2014

As described earlier in this report, overall business performance in the year included:

- Recovery efforts in bringing the railway back quickly and safely after extreme storms and floods
- Completion of the first phase of Reading station redevelopment
- Improvements to London Bridge, Nottingham and Hitchin stations
- Improvements in our safety culture.

At the same time, in some areas there remains work to be done as performance fell short of the very stretching targets which we set for ourselves under the AIP at the start of the year. The committee's assessment of performance for 2014 is described in detail on pages 79-80, and summarised in the chart below. In making the assessment, the committee took into account the performance against target of each of the measures, an overall view of business performance and specific views from the audit and risk committee, the safety health and environment committee and the ORR. Based on this assessment, a bonus of 20.9 per cent of the maximum, which was 60 per cent of salary, was awarded to eligible executive directors, equating to 12.5 per cent of salary, as shown in the single figure of remuneration table on page 78.

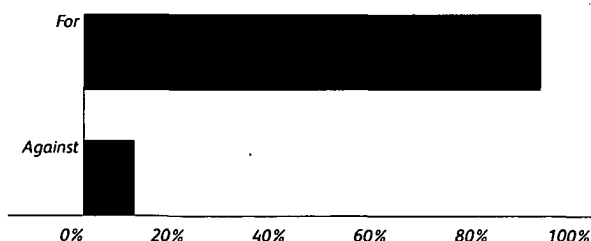
	7 Key business measures	Weighting	Minimum performance level	Target performance level	Maximum performance level
Value through cost savings	Cost efficiency measure	20 %	17.0 %	21.0 %	23.0 %
Investing in the railway	Asset stewardship indicator	20 %	0.093	0.111	0.123
	Investment milestones	10 %	Determined by Remuneration committee		
Delivering for our passengers	Public performance measure	27 %	90.9 %	92.0 %	92.5 %
	Passenger satisfaction	10 %	84.3 %	84.3 %	84.6 %
Serving our customers	Customer satisfaction	10 %	Determined by Remuneration committee		
	Freight performance measure	3 %	74.1 %	74.9 %	77.0 %

Retention payments

The conditions for the retention payments which were approved by our members at the 2012 AGM were met and they have now been paid to three executive directors. As described above, under the remuneration policy for CP5, no further retention payments can be awarded to serving directors.

Members – engagement and support

At the 2013 AGM, we received 95 per cent support from our members for the 2013 directors' remuneration report.



We have continued to receive active and informative input from our members as part of our ongoing programme of stakeholder engagement and I would like to personally thank them all for their involvement and support during the year. We hope to receive their continued strong support for the remuneration resolutions at the 2014 AGM.

Michael O'Higgins
Chairman of the remuneration committee

Annual remuneration report –

Executive director remuneration framework for 2015

Determining executive pay at Network Rail – best practice corporate governance

As a commercial organisation, Network Rail operates under a corporate governance structure in line with best practice principles. The remuneration of the executive directors is determined by the remuneration committee and subject to approvals, as appropriate, from members as illustrated below, in line with the Regulations.



Remuneration committee

- A committee of independent non-executive directors
- The full terms of reference of the committee are available on the website.⁵

The committee is responsible for determining the remuneration policy for Network Rail which sets out the overall framework for how executive remuneration will operate.

Following approval of the remuneration policy by members, the committee is responsible for implementing it each year. This includes making decisions on, for example:

- Salary levels
- Setting and assessing performance targets
- Arrangements for joiners and leavers.

All payments and arrangements must be within the terms of the approved remuneration policy.

The committee's decisions are reported in the annual remuneration report each year.



Members

- The role of public members is similar to the role of shareholders in public limited companies
- Members have two votes (on remuneration) at the company's AGM.



First, members must approve the remuneration policy, which will apply for a maximum of three years.

The vote is binding and any subsequent payments must be in line with the approved remuneration policy.



Secondly, members have an opportunity to vote on the annual remuneration report at the AGM each year.

This allows members to express a view on how the committee has implemented the policy in the year. In line with the regulations, the vote is advisory only.

As the regulator, the ORR must also confirm that the incentive arrangements meet the licence conditions.

Annual remuneration report continued

Principles which underpin the framework

Simple	Competitive and fair	Performance and safety	Aligned with employees
The framework should be clear and transparent for all stakeholders.	Remuneration should appropriately reflect the skills and experience of the individual and the scope and complexity of the role. At the same time, should provide value for money for taxpayers.	The incentive framework should reward exceptional performance in the areas most important for our stakeholders – such as safety, train performance and financial management. No reward for failure.	The incentive structure is cascaded to all 34,000 Network Rail employees to create an alignment throughout the business.

Summary of remuneration policy for CP5

The structure of the remuneration framework for executive directors in CP5 is summarised below. No payments outside of this framework can be made following member approval of the policy at the 2014 AGM

Fixed remuneration	Salary	<ul style="list-style-type: none">Salaries are set at a level which reflects the skills and experience of the individual as well as the scope and responsibilities of the role. Salaries with effect from 1 July 2014 are:<table><tr><td>Mark Carne</td><td>£675k</td><td>Robin Gisby</td><td>£388k</td></tr><tr><td>Patrick Butcher</td><td>£412k</td><td>Paul Plummer</td><td>£364k</td></tr></table>Salary increases will normally be in line with the typical salary increase for the overall employee population over the same period.	Mark Carne	£675k	Robin Gisby	£388k	Patrick Butcher	£412k	Paul Plummer	£364k
	Mark Carne	£675k	Robin Gisby	£388k						
	Patrick Butcher	£412k	Paul Plummer	£364k						
	Benefits	<ul style="list-style-type: none">Includes discounted rail travel and life insurance in line with all Network Rail employees, as well as car and healthcare benefits aligned with those for other management positions.								
Pension	<ul style="list-style-type: none">Eligible to participate in Network Rail pension schemes on the same basis as all employeesTo provide a market competitive pension benefit, executive directors and senior managers may also receive a supplementary cash allowance of 10 per cent of salary above the Network Rail pension cap (30 per cent for existing executives).									
Performance related	Incentive	<ul style="list-style-type: none">One incentive plan based on the achievement of stretching annual performance targets in the areas which our stakeholders care most aboutAll 34,000 Network Rail employees are eligible to participate, based on aligned performance targetsFor executive directors, a maximum annual opportunity of 20 per cent of salary, subject to performanceAny amount is deferred for three years, subject to safety and sustainability obligations over the period.								

Any new appointments would be based on the framework above. Should an executive director leave the business, there would be no reward for failure.

Further detail on the framework above is provided in the remuneration policy on pages 85-92.

Incentive structure for executive directors – aligned to the things which matter for stakeholders

Performance targets framework

For executive directors, half of the incentive is based on a corporate scorecard of measures split equally between long-term stewardship of the railway and annual operating performance. The measures are aligned with CPS regulatory targets and areas which matter most to stakeholders.

Other Network Rail employees are eligible to participate in an incentive consistent with this corporate performance framework, ensuring shared objectives and reward throughout the business.

The remaining half is based on targets specific to the business unit or area of responsibility for each executive director which allows for incentive payments to more appropriately reflect the performance of different business areas.

Overall business performance

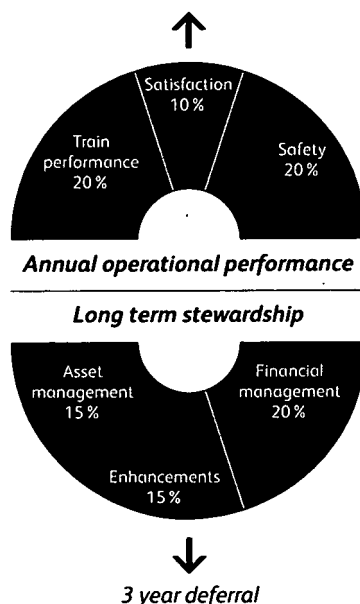
The committee also consider overall business performance in the year, including safety performance, and may adjust outcomes on this basis. In the event of a serious incident for which Network Rail was responsible, no incentive would normally be payable to any executive director.

Deferral – safety and sustainability obligations

For executive directors, any amount earned would be deferred for a period of three years, in line with best practice.

To pay any deferred amount, the committee must confirm the safety and sustainability obligations over the deferral period have been met. To the extent they are not met, the committee can reduce the deferred amount.

Framework cascaded to the incentive opportunities of all Network Rail employees



Safety and sustainability obligations

- **Safety.** In the event of a serious incident impacting the safety of passengers, workforce or the general public for which Network Rail was responsible, the committee has the discretion to reduce deferred amounts.
- **Sustainability of business performance.** The committee's assessment that performance delivered in the performance year has been appropriately sustained over the deferral period.

Annual remuneration report continued

Balanced scorecard business performance targets for 2015

The following table summarises the specific business performance targets for executive directors for the 2015 financial year, based on the framework described above. The highest and equal weighting has been given to safety, train performance and financial outperformance.

Rationale	Key business measures	Weighting	Minimum performance level	Target performance level	Maximum performance level
Safety 20% Transforming safety is a core objective for CP5	4 key targets measure workforce, passenger and public safety	20%	4 key targets measure safety performance		
Train performance 20% Train performance is a key CP5 objective	Public performance measure (PPM), England, Wales, Scotland	18%	90.0%	91.1%	91.6%
	Freight delivery metric (FDM), England, Wales, Scotland	2%	92.0%	92.5%	95.0%
Financial outperformance 20% A key measure of performance. Cost reduction delivers long-term savings for taxpayers and farepayers	Income, expenditure and Capex	20%	Miss target by less than £170m	Budget	Beat target by greater than £170m
Investment (investing in the railway) 15% Enhancements are a key CP5 objective. Targets reflect both major projects and all enhancements.	Enhancement interim milestones of top 10 enhancement projects	7.5%	6	8	10
	Enhancement interim milestones of all enhancement projects as a % of milestones achieved	7.5%	6	8	10
Asset management 15% Long-term reliability and safety of the network is a core business objective	Composite reliability index	7.5%	0.87%	5.71%	10.26%
	Renewals volume	7.5%	7 key targets measure renewals volumes		
Satisfaction 10% Key independent external measures of performance from key stakeholders.	Customer satisfaction	5%	3.15	3.32	3.49
	Passenger satisfaction	5%	81.0%	83.3%	86.0%

Stakeholder engagement

Last year, there was a comprehensive review of how the committee should engage with stakeholders to ensure a transparent and ongoing dialogue on the issue of executive remuneration.

The committee engages with members as part of a regular and co-ordinated annual programme designed to share the information which informs the committee's decision making and to seek member feedback on key issues. During the year, this included five workshops and a half year meeting to which all members are invited. It also included two meetings of the people engagement group, a sub-group of members introduced during 2013, which discusses a range of people-related issues including executive remuneration in greater depth. The development of the CP5 framework was discussed in detail during these forums and input from members directly informed the final proposals in a number of areas.

In addition, there are regular discussions with the Office of Rail Regulation (ORR) to ensure that the incentive arrangements meet the license conditions. The principal funders of Network Rail, the Department for Transport and Transport for Scotland, are also regularly updated on the implementation of the executive remuneration framework during the year.

Management changes

The remuneration arrangements for executive directors who joined or left the board during 2014 (or early 2015) were determined by the committee in line with the company's established policies and principles of best practice. The arrangements are summarised below.

Mark Carne	<ul style="list-style-type: none">• Joined the board on 6 January 2014 and succeeded David Higgins as chief executive on 24 February 2014. In overall terms, the remuneration package did not exceed that of his predecessor• Appointed on a salary of £675,000 per annum• To reflect the limited time of employment during 2014, there was no eligibility for AIP for that year• Eligible to participate in Network Rail pension schemes on the same basis as all employees. In line with the policy, he will receive an additional pension allowance of 10 per cent of salary above the Network Rail earnings cap• Will not participate in any previous LTIP awards• Received a one off reimbursement of relocation costs of £25,000.
David Higgins	<ul style="list-style-type: none">• Stepped down from the Network Rail board and from the role of chief executive on 28 February 2014. After this time he took up his appointment of HS2 Chairman• The period of notice was worked and no payment in lieu of notice, or any other termination payment, was or will be made• Remained eligible for 2014 AIP on a pro-rata basis to reflect 11 months' period of service as chief executive (i.e. the maximum opportunity was reduced from 60 per cent to 55 per cent of salary). The actual amount paid, based on performance, is shown in the single total figure of remuneration table• The outstanding award under the 2012-15 LTIP lapsed under the terms of the plan to reflect cessation of employment as a Network Rail executive director during the performance period.
Simon Kirby	<ul style="list-style-type: none">• Stepped down from the Network Rail board on 18 May 2014• There was no payment in lieu of notice, or any other termination payment made• Remained eligible for 2014 AIP to reflect full period of service as an executive director in the year. The actual amount paid, based on performance, is shown in the single total figure of remuneration table• No eligibility for the 2015 incentive• The outstanding award under the 2012-15 LTIP lapsed under the terms of the plan to reflect cessation of employment as a Network Rail executive director during the performance period• Remained eligible for the deferred payment under the 2009-12 LTIP to reflect performance and service over the performance period which ended in respect of performance to 2012. Further details of the deferred amount are set out on page 81• Simon's replacement is not a board appointment.

Annual remuneration report continued

Single total figure of remuneration for 2014 (audited)

The table below summarises all remuneration for the executive directors in respect of 2014 (and the prior year comparative). Further discussion of each of the components is set out on the pages which follow.

£'000	Salary		Benefits ³		Pension ⁴		AIP ⁵		LTIP ⁶		Other ⁷		Total	
	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013	2014	2013
David Higgins ¹	542	573	15	15	165	176	68	99	–	–	–	–	790	863
Mark Carne ²	156	–	28	–	16	–	–	–	–	–	–	–	200	–
Patrick Butcher	401	391	15	15	155	153	51	68	–	–	300	–	922	627
Robin Gisby	378	368	16	15	148	173	48	64	–	–	300	–	880	620
Simon Kirby	378	368	15	15	149	163	48	64	–	–	300	–	890	620
Paul Plummer	355	346	17	15	150	166	45	60	–	–	–	–	567	587

1 David Higgins stepped down from the board on 28 February 2014. The figures shown above represent his remuneration in respect of this period.

2 Mark Carne was appointed to the board on 6 January 2014.

3 Benefits include car allowance, private medical cover, any annual travel subsidy, life insurance and relocation costs reimbursed.

4 Pension includes the value of all pension benefits receivable in respect of the relevant year. This includes both the supplementary cash allowance and a value from participation in the defined benefit or defined contribution pension arrangements (calculated in accordance with the methodology prescribed by the Regulations). Further details of these pension benefits are set out in the Pensions section on page 82.

5 AIP includes the value of the Annual Incentive Plan awarded in respect of the relevant financial year. Further details of the performance achieved are shown in the section below.

6 There was no LTIP award which vested in respect of a performance period measured to the financial year 2013 or 2014. Therefore, in accordance with the Regulations, no value is shown in either of these columns. Details of outstanding LTIP awards are provided in the Long Term Incentive Plan section on pages 80-82.

7 The Other column contains the value of the one-off retention payments approved by members at the 2012 AGM and paid in 2014.

Policy on non-executive directors' fees

Fees are reviewed bi-annually and, with the exception of the fee for the chairman (which is determined by the committee), are set by the executive directors to attract individuals with the appropriate range of skills and experience. In determining the level of fees their duties and responsibilities are considered, together with the level of time commitment required in preparing for and attending meetings.

The fees were last reviewed in 2013 and no increase in base fees or committee chair fees were awarded.

The table below summarises the remuneration for the non-executive directors in respect of 2014.

£'000	Fees	
	2014	2013
Malcolm Brinded	57	50
Graham Eccles ¹	17	57
Mike Firth	56	59
Chris Gibb ²	7	–
Lawrie Haynes	53	60
Janis Kong	50	50
Keith Ludeman	79	66
Michael O'Higgins	57	18
Richard Parry-Jones	250	174
Bridget Rosewall	60	60

1 Graham Eccles stepped down from the board following the AGM on 18 July 2013.

2 Chris Gibb was appointed to the board on 12 November 2013.

AIP performance targets 2014 (audited)

The maximum potential AIP award for executive directors in 2014 was 60 per cent of salary. Stretching performance targets were set at the start of the year in the context of business objectives and CP4 regulatory targets.

The table below summarise the targets for the year and illustrates how actual performance compared to the target ranges. Detailed discussion of performance in each area is set out below the table.

	Below threshold – nil vesting	Threshold performance	Target	Maximum	Weighting	Payout percentage	
Value through cost savings							
Cost efficiency which is the annual cost of Network Rail, normalised by capacity provided and adjusted by renewals activity and compared to base year	13.1%	17%	21%	23%	20%	0.0%	
Investing in the railway							
Asset stewardship indicator measures the quality of Network Rail's asset stewardship based on asset condition, reliability and performance		0.093%	0.104%	0.111%	0.123%	20%	6.1%
Progress on infrastructure projects is measured through reports against achievement of key milestones for the year		0	12	86%	14	10%	8.6%
Delivering for our passengers							
Passenger performance measures the percentage of trains arriving on time	90%	90.9%	92.0%	92.5%	27%	0%	
Passenger satisfaction with rail travel is measured through the National Passenger Survey	82.4%	84.3%	84.3%	84.6%	10%	0%	
Serving our customers							
Customer satisfaction is an assessment of how well Network Rail engages with its key customers		3.5	3.5	3.5	10	10%	5%
Freight performance measures the percentage of freight trains arriving on time		74.1%	74.8%	74.9%	77%	3%	1.4%
Overall result before safety modifiers						21.1%	
Overall result with discretionary 5% increase by remuneration committee						26.1%	
Overall after safety, health and environment committee reduction (20% decrease)						20.9%	

Note: At the low threshold zero incentive is payable. At the high threshold the maximum incentive is payable. At the target 50 per cent of the maximum is payable. Other performance levels between low and high trigger pro rata percentages of the maximum.

- **Train performance:** passenger performance was below the threshold for payment this year and as a result, no payment was made in relation to this measure, which accounted for 27 per cent of overall bonus. For freight performance (three per cent of overall bonus) the final result was above threshold, which triggered a payment.
- **Asset stewardship indicator** performance was above threshold and therefore triggered a payment. ASI is an index of 25 separate measures of asset reliability and condition. We ended the control period with a score of 0.104, equivalent to a 10.4 per cent improvement over our CP3 out-turn, and ahead of our 0.93 threshold for bonus award.
- **Cost efficiency** during the year was below the threshold and therefore no payment was made.
- **Passenger satisfaction** is measured through the National Passenger Survey, commissioned by Passenger Focus, which provides an independent network-wide picture of passenger's satisfaction with rail travel. Passenger satisfaction during the year was below threshold and therefore no payment was made under this measure.

Annual remuneration report continued

- **Customer satisfaction** is an assessment of how well Network Rail engages with its key customers, principally passenger and freight operating companies. It is measured by the Customer Satisfaction Survey, carried out by an independent third party, and takes into account the customer satisfaction achieved in each of the Network Rail routes. We met our target so there was a payment under this measure.
- **Progress on infrastructure projects** is measured through reports against achievement of key milestones for the year. During 2014 performance against key milestones aimed at improving and expanding the railway was good including improvements at London Bridge, Nottingham and Hitchin stations, completion of the first phase of Reading station redevelopment and Birmingham Gateway. We met our targets and received a payment under this measure.

The committee also considered overall business performance in the year, taking into account a range of factors in deciding whether to adjust the overall payment downwards or upwards. These factors included the ORR's annual assessment of Network Rail's performance reports from the safety, health and environment, audit and risk committees and the strong recovery of the railway quickly and safely after the extreme weather.

The ORR recognised successes during the year including an increase in both passenger and freight journeys, and achieving a 30.9 per cent risk reduction in level crossings in CP4, exceeding our target of 25 per cent. The ORR also acknowledged that Network Rail worked well with industry to cope with some very challenging weather conditions. They commented that the restoration work at Dawlish, and the reopening of the line at Easter ahead of schedule, should be particularly celebrated. However the ORR acknowledged areas where we felt short of targets we were funded to deliver, including punctuality and reliability (where we did not meet the regulatory output), and noted that customer and passenger satisfaction had also fallen compared to the previous year. Enforcement notices related to some serious and significant matters that had network wide implications and highlighted concern about the effect of deferred renewals.

The safety, health and environment (SHE) committee acknowledged that comprehensive programmes have been instigated in the last two years to improve both passenger safety and workforce safety. These programmes are considered to be well-targeted and well-managed, and reflect approaches that have been proven world-wide in many industries. But so far the impact on actual performance has been limited, and the safety results for 2014 did not improve on 2013. Though passenger safety shows positive trends – and we benchmark as the safest major railway in Europe – there are still issues where improvement is needed. Workforce safety has effectively plateaued, and the year tragically included workforce fatal incidents (including a road traffic accident with two fatalities). In the light of this, the SHE committee recommended that management bonuses will be reduced by 20 per cent of what they otherwise would have been.

Taking an overall view of performance the remuneration committee determined that it was appropriate to apply an increase of 5 per cent to reflect the outstanding performance in adverse weather and also to implement the 0.8x factor (20 per cent reduction) recommended by the SHE committee. The impact on the bonus outcome can be seen in the table. The five per cent adjustment was also applied to the workforce.

As discussed above, the incentive framework is changing for CP5. Discussion of the framework and targets for 2015 is set out on page 76.

Long-term incentive plan (audited)

The interests of the executive directors in outstanding long-term incentive plan awards approved by members is summarised in this section.

As discussed above, the incentive framework is changing for CP5. No further LTIP schemes will be introduced.

2009-12 LTIP – earned and deferred

Key features

- Awards approved by members at 2009 AGM
- Based on a performance period covering the three year period to 31 March 2012, which is now complete
- Vesting was based on Financial Value Added (FVA) performance target, and assessment of overall business performance (including safety)
- Committee assessed performance and determined that 80 per cent of the maximum should vest, reflecting the delivery of £698m of FVA which was significantly ahead of the target
- Payment in two phases. First paid in April 2013 and second due in 2014, subject to ORR verification of FVA performance.

As disclosed in detail in the 2013 directors' remuneration report, the committee determined that, based on the achieved performance in the period (as adjusted downwards for safety and train performance in the period), 80 per cent of the maximum should vest.

The committee, mindful that the final FVA figure for the performance period could not be verified by the ORR until the end of CP4, made the decision to make the payments in two phases.

The first payment was made in April 2013. However, because the 2009-12 LTIP vested in respect of performance to the 2012 financial year, in accordance with the Regulations no value is included in the 2013 or 2014 columns of the single total figure of remuneration table on page 78.

The second payment was deferred to provide a mechanism for any adjustments which may be required following final ORR verification of FVA. The control period finished on 31 March 2014, and the formal ORR view on FVA for the control period will be published over the coming months. Once this has been done, in accordance with the commitment made in the 2013 directors' remuneration report, the committee will consult with members prior to finalising the outcome. Full details will be disclosed in next year's report.

The following table summarises the outstanding awards under the 2009-12 LTIP.

	Date of award*	Performance period	Maximum value of initial award £000	Changes since award**		Deferred amount***	
				Payment of first tranche (April 2013)	Lapsed amount	Value	Date of payment
David Higgins	No award						
Mark Carne	No award						
Patrick Butcher	2009	2009-2012 (completed)	350	(168)	(70)	112	TBC 2014
Robin Gisby	2009	2009-2012 (completed)	330	(158)	(66)	106	TBC 2014
Simon Kirby	2009	2009-2012 (completed)	330	(158)	(66)	106	TBC 2014
Paul Plummer	2009	2009-2012 (completed)	310	(149)	(62)	99	TBC 2014

* Awards were made following member approval at the 2009 AGM.

** Columns illustrate the change in the outstanding value of the award to reflect the first payment of the vested amount to reflect the committee's assessment of performance and the amount which lapsed as a result of the committee's performance assessment (20 per cent of the total).

*** Shows the remaining value of the second payment due to be paid in 2014, subject to ORR verification of FVA.

2012-15 LTIP – in progress

Key features

- Awards approved by members at 2013 AGM
- Based on a performance period covering the three year period to 31 March 2015, which is in progress
- Vesting will be based on performance in three areas: 50 per cent based on Financial Value Added (FVA), 25 per cent based on PPM, and 25 per cent based on project milestones
- Subject to this performance, awards will pay out in 2015.

The performance targets for this award are set out below and were discussed in detail in the 2013 directors' remuneration report.

	% of maximum	Performance measures		
		Cumulative FVA over FY13-FY15	PPM moving annual average (FY15)	Project milestones
Proportion of award		50 %	25 %	25 %
Performance above expectations	25 %	£75m	92.5 %	Delivery above expectations
Exceptional performance	100 %	£450m or above	93.0 % or above	Exceptional delivery

No payment below the threshold performance level. For performance between the levels shown, vesting will be on a scaled basis.

The LTIP uses two underpins and the committee retains discretion to make a suitable downward adjustment to vesting levels if the underpins are not satisfied. This is to provide a safeguard such that performance in one area must not be achieved at the expense of the other. Any vesting on the operational measures is subject to a positive cumulative FVA over the period. Any vesting on the FVA measure is subject to the committee's assessment that key regulatory outputs have been sufficiently delivered.

Under the clawback provision, the committee has discretion to reduce or cancel an award at any time before vesting, if circumstances are considered appropriate. These include:

- Gross misconduct
- A material misstatement of the company's audited results
- An unacceptable level of safety performance. In the event of a catastrophic accident for which Network Rail was culpable, no LTIP would normally be payable to any Network Rail executive director
- A material failure of risk management
- A failure to comply with obligations set out in applicable contractual agreements
- Serious reputational damage to the Company as a result of the participant's misconduct.

Annual remuneration report continued

The 2013 directors' remuneration report stated that as the plan spans two control periods, the targets would be verified once the determination was published and targets for the period in CP5 that this plan covers have been finalised. The committee will review the targets now the determination has been finalised and disclose the outcome in next year's report.

The following table summarises the outstanding awards under the 2012-15 LTIP. As shown, awards to David Higgins and Simon Kirby lapsed/will lapse under the terms of the plan to reflect cessation of employment as a Network Rail executive director during the performance period.

£000	Date of award*	Performance period	Maximum value of initial award	Changes since award**	Current maximum value of award	Date of payment***
David Higgins	2013	2012-2015 (in progress)	577	(577)	–	Lapsed
Mark Carne	No award	–	–	–	–	–
Patrick Butcher	2013	2012-2015 (in progress)	395	–	395	2015
Robin Gisby	2013	2012-2015 (in progress)	371	–	371	2015
Simon Kirby	2013	2012-2015 (in progress)	371	(371)	–	Lapsed
Paul Plummer	2013	2012-2015 (in progress)	338	–	338	2015

* Awards were made following member approval at the 2013 AGM.

** Illustrates the change in the outstanding value of the award to reflect awards lapsing on cessation of employment as a Network Rail executive director during the performance period.

*** Subject to performance assessment and verification of the targets set out above.

Pension (audited)

Executive directors are eligible to participate in the Network Rail defined benefit pension schemes or defined contribution pension scheme on the same basis as other employees. Executive directors who have opted out of their respective pension arrangements to protect their lifetime allowance of £1.5m are eligible to receive a pension allowance on the same basis as other employees. This allowance is equivalent to the employer's pensions contributions otherwise payable to the relevant pension scheme less the cost of providing continued life cover and less the employer National Insurance Contributions payable. In respect of salary above the Network Rail earnings cap (currently £145,800 but benefits were based on last year's value £141,000), executive directors and senior management may receive an additional pension allowance in the form of a cash salary supplement or contribution to a defined contribution scheme.

The table below sets out details for executive directors for 2014 in respect of all Network Rail pension benefits, split between the defined benefit and defined contribution/additional allowance. The value shown in the final column of this table is included as the pension column in the single total figure of remuneration on page 78.

	Normal retirement age	Defined benefit schemes			Other pension arrangements		Total pension value reported in the Single Figure table (A+B)
		Accrued pension at 31 March 2014 £000	Increase in accrued pension (net of inflation) during 2014	Transfer value of accrued pension at 31 March 2014	Value included in single figure table (A)	Cash salary supplement or contribution to defined contribution scheme (B)	
David Higgins	65	–	–	55	9	156	165
Mark Carne	–	–	–	–	–	16	16
Patrick Butcher	65	11	2	124	41	114	155
Robin Gisby	60	40	2	704	41	107	148
Simon Kirby	60	25	2	248	42	107	149
Paul Plummer	60	32	2	317	50	100	150

The normal retirement age shows the age at which the director can retire without actuarial reduction.

Transfer values as at 31 March 2014 have been calculated in accordance with 'The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008'.

For the defined benefit schemes, the value shown in the Single Figure table (A) has been calculated in accordance with the Regulations by applying a multiplier of 20x to the increase in accrued pension (net of inflation) during the year. For the additional pension allowance (B), the value shown is the gross cash allowance/contribution in the year. The value shown in the single figure table is the sum of A and B.

Payments to former directors (audited)

There were no payments to former directors during 2014.

Payments for loss of office (audited)

There were no payments for loss of office during 2014.

Outside appointments

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

During 2014, David Higgins was a non-executive director of Sirius Minerals plc with an annual fee of £25,000 per annum, which he received pro rata as he left on 1 January 2014 and a non-executive director of the Rail Safety and Standards Board during the year (receiving no fees).

Patrick Butcher is a member of the British Transport Policy Authority. No fees are received for this role.

Additional disclosures

The following disclosures are required by the regulations to provide additional context for considering executive remuneration.

Percentage change in remuneration

The table below shows the percentage change in the salary, benefits and AIP of the chief executive and all Network Rail employees from 2013 to 2014.

David Higgins was the chief executive until 28 February 2014. For the purposes of the table below, the annual change in the value of each of the components for the chief executive has been calculated using the data disclosed in the relevant columns of the single total figure of remuneration table on page 78 (with the values for 2014 converted to an annualised figure to ensure an appropriate year on year comparison).

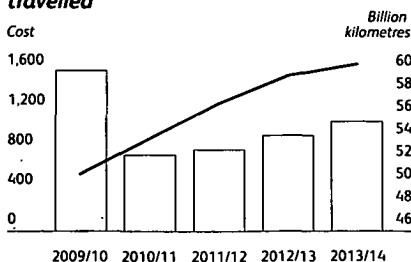
	Chief executive	All employees
Salary	2.5 %	2.94 %
Benefits	0.0 %	0.0 %
AIP	-35 %	0.0 %

Performance graph and table

Under the regulations, companies are required to include a chart showing historic total shareholder return (i.e. share price and re-invested dividends) over a five-year period alongside a table which shows the remuneration paid to the chief executive over the same period.

Network Rail has no listed shares and therefore cannot provide the required chart. However, in line with the principle of this disclosure, the chart below tracks the performance of key Network Rail performance indicators over a five year period and the table below provides remuneration data for the individuals occupying the role of chief executive for each financial year over the equivalent period.

Number of passenger kilometres travelled



□ CEO cost
■ Passenger growth

Annual remuneration report continued

	2014		2013		2012		2011		2010	
Chief executive	David Higgins	Mark Carne	David Higgins	David Higgins	Iain Coucher	David Higgins	Iain Coucher			
Single total figure of remuneration	£790k	£200k	£863k	£736k	£582k	£161k	£1,447k			
AIP (% of Maximum)	20.9 %	N/A	28.6 %	0 %	N/A	N/A	56.8 %			
LTIP vesting (% of Maximum)	N/A	N/A	N/A	N/A	N/A	N/A	47.8 %			

David Higgins was appointed chief executive on 1 February 2011

Mark Carne was appointed chief executive on 24 February 2014

N/A indicates that there was no eligibility for an award vesting in respect of the relevant year.

Relative importance of spend on pay

Under the regulations, companies are required to illustrate the relative importance of spend on pay by disclosing the total employee remuneration and returns to shareholders (i.e. dividends and share buybacks) in the reporting year and the prior year. Network Rail is a not-for-dividend company and therefore cannot provide data on returns to shareholders. Therefore, in line with the principle of this disclosure, the table below includes other key Network Rail metrics to illustrate employee remuneration in the context of overall business activities.

	2014	2013	Change (%)
Total employee remuneration	£1,910m	£1,789m	6
Total expenditure	£9,589m	£7,498m	22

Consideration of directors' remuneration – Remuneration Committee and advisers

The membership of the committee during the year comprised the following independent non-executive directors: Michael O'Higgins (chairman from 18 July 2013), Richard Parry Jones, and Mike Firth. Graham Eccles was chairman of the committee until stepping down from the board following the AGM on 18 July 2013.

The group general counsel is secretary to the committee. The committee is also supported by the director, Human Resources, head of reward and benefits and deputy company secretary. The chief executive attends meetings at the invitation of the committee. No individual is present when their own remuneration is being discussed.

Key remuneration committee agenda items during the year

April 2013	• Review of draft directors' remuneration report
May 2013	• 2014 annual incentive plan design proposals • 2013 annual incentive plan out-turn proposals • Executive director annual salary review proposals
June 2013	• Approval of 2013 annual incentive plan out-turn • CP5 remuneration proposals – framework and timeline
August 2013	• CEO package
September 2013	• CP5 remuneration framework and implications of BIS regulations • Discussion on long term incentives and ORR efficiency and finance assessment
November 2013	• CP5 remuneration – incentive scheme design, pension policy and BIS remuneration policy approach
January 2014	• CP5 remuneration – incentive scheme design • Executive pension arrangements
February 2014	• CP5 remuneration – incentive scheme design
March 2014	• CP5 remuneration – incentive scheme design, safety and sustainability obligation, performance measures • Approval of retention payments • Review of incentives policy

In carrying out its responsibilities in line with best practice, the committee seeks independent external advice as necessary. During the year the committee retained Deloitte LLP to provide independent advice on the major review of remuneration principles and the development of the CP5 remuneration framework. Deloitte had been appointed by the committee during 2012 following a selection process undertaken by the committee. The committee is comfortable that the Deloitte engagement partner and team provide objective and independent remuneration advice to the committee and do not have any connections with Network Rail that may impair their objectivity and independence. Deloitte is a founding member of the Remuneration Consultants Group and voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK. The code of conduct can be found at www.remunerationconsultantsgroup.com. During 2014, Deloitte provided independent advice to the committee in respect of the committee's extensive programme of work in the year which included a major review of remuneration principles, the development of the CP5 remuneration framework, determining arrangements for departing and new executive directors, as well as the adoption of new remuneration reporting requirements. The fees charged by Deloitte for the provision of independent advice to the committee during 2014 were £94,500. Deloitte also provide services to the group in respect of programme support to Network Operations, Asset Information and Energy Services, and property advice.

Statement of voting at annual general meeting

At the annual general meeting held on 18 July 2013, votes cast in respect of directors' remuneration were:

Resolution	Votes For		Votes Against		Total votes cast	Votes Withheld
	#	%	#	%		
Approval of directors' remuneration report for 2013	37	94.87 %	2	5.13 %	39	2
Approval of the Management Incentive Plan	32	86.49 %	5	13.51 %	37	4

Remuneration policy

This remuneration policy (policy) has been determined by the Network Rail remuneration committee (the committee) in accordance with the requirements of Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. The policy will be effective following the date of the 2014 annual general meeting, subject to approval from members.

Consideration of stakeholder views in developing the policy

In formulating the policy, the committee consulted widely with the following key stakeholders:

- **Members.** Reflecting an established commitment to on-going and transparent dialogue, the committee engaged with the company's members through workshops and engagement groups held regularly throughout the whole of the development process. Feedback from this engagement was taken into account by the committee at every stage of the process, from initial consideration of high level principles to detailed points of the final framework.
- **Regulator and funders.** The committee consulted widely with the ORR and the Department for Transport/Transport Scotland.
- **Employees.** Various communication processes exist for the views of employees to be conveyed to the committee, and such views are taken into account. One of the key underlying principles is that, as far as practicable and appropriate, the remuneration framework for the executive directors should be aligned with that which applies for other managers and employees throughout the organisation. As a result, the pay, remuneration structures and employment conditions throughout the Group were considered by the committee in developing the policy. The policy table overleaf illustrates the significant alignment between the framework for executive directors and for employees in general.

Remuneration policy continued

Policy table for executive directors

The final column indicates how the framework for executive directors is aligned with other managers and employees throughout the organisation.

Component	Purpose/link to strategy	Operation	Quantum	Alignment with employees
Base salary	To provide an element of fixed remuneration which reflects the skills and experience of the individual, allowing the company to recruit the calibre of individual needed to lead the business.	<p>Salaries of executive directors are determined by the committee using the same principles and approach as applied across Network Rail.</p> <p>Salaries are set at a level which reflects the skills and experience of the individual as well as the scope and responsibilities of the role.</p> <p>In considering the above, the committee takes into account levels of remuneration within Network Rail and in the market, based on information for similar roles in comparable organisations.</p> <p>Salaries are reviewed annually and any changes normally effective from 1 July</p> <p>Salaries effective 1 July 2014 are:</p> <ul style="list-style-type: none"> • Mark Carne: £675k • Patrick Butcher: £412k • Robin Gisby: £388k • Paul Plummer: £364k 	<p>The approach to determining salary increases for executive directors is aligned to that used across the company.</p> <p>There is no defined maximum salary. Salary increases will normally be in line with the typical salary increase for the overall employee population over the same period.</p> <p>Increases above this level may be made by the committee in circumstances where it considers it appropriate, such as to reflect:</p> <ul style="list-style-type: none"> • An increase in the scope and responsibilities of the role • A change in role; or • Performance in the role. 	Salaries for all employees are determined by applying the same principles as described here.
Benefits	To provide a benefits package aligned with other senior managers and employees at Network Rail.	<p>This includes the following benefits in line with other senior managers and employees:</p> <ul style="list-style-type: none"> • Car allowance • Private healthcare/assessments • Discounted rail travel • Life insurance. <p>Where the committee considers it appropriate for the circumstances of the individual, other travel or relocation related benefits may be provided.</p>	<p>Car allowance: Currently £13,000 per annum (which may increase in line with salary increases).</p> <p>The nature of the healthcare, rail travel and life insurance benefits is fixed, but the monetary value may vary each year.</p>	<p>All Network Rail employees are entitled to discounted rail travel and life insurance.</p> <p>The car allowance and healthcare benefits are in line with the market competitive policy for other senior managers.</p>

Component	Purpose/link to strategy	Operation	Quantum	Alignment with employees
<i>Pension</i>	To provide a retirement benefit in line with other senior managers and employees at Network Rail.	<p>Executives may participate in any of the three Network Rail occupational pension schemes, on the same terms as all employees. There are two defined benefit (DB) schemes (final salary and career average) and a defined contribution (DC) scheme. Executive directors contribute at the same rate as other members of the respective scheme.</p> <p>Benefits in the above schemes are limited to a cap on pensionable earnings (£144,800 from April 2014, subject to annual review). To allow a market competitive retirement benefit, executive directors (and some senior managers) may receive an additional cash allowance on their salary above the earnings cap.</p> <p>Executives who chose to opt out of one of the three Network Rail occupational pension schemes to protect their lifetime allowance of £1.5m are eligible to receive a pension allowance, on the same terms as other members of the respective schemes who chose to opt out for this reason. This allowance is equivalent to the employer's pensions contributions otherwise payable to the relevant pension scheme less the cost of providing continued life cover and less the employer National Insurance Contributions payable.</p>	<p>The DB schemes have an accrual rate of 1/60th of pensionable earnings.</p> <p>The maximum employer contribution under the DC scheme is seven per cent of pensionable earnings.</p> <p>For executives appointed after 1 January 2014, the maximum additional cash allowance is 10 per cent of salary above the earnings cap (for executives appointed before that date, the maximum is 30 per cent).</p>	All employees are eligible to participate in any of the three Network Rail occupational pension schemes.

Remuneration policy continued

Component	Purpose/link to strategy	Operation	Quantum	Alignment with employees
Incentive	<p>To provide alignment between business performance delivered for stakeholders and reward.</p> <p>Cascading the performance framework throughout the organisation creates aligned objectives and shared successes.</p> <p>Deferral assists retention and is in line with best practice.</p> <p>Required by the licence agreement.</p>	<p>The incentive provides an opportunity to reward performance delivered for stakeholders.</p> <p>Following the end of the financial year, the committee will assess performance against stretching performance targets set at the start of the year.</p> <p>The committee also has an overriding discretion to make adjustments to reflect its assessment of overall business performance in the year, including safety performance.</p> <p>Any payment based on the assessment above is deferred for a period of three years.</p> <p>Deferred amounts are subject to continued employment and will normally lapse on leaving employment over the deferral period unless the committee determines that the individual is a 'good leaver' (see Exit Policy section).</p> <p>The payment of deferred amounts is subject to meeting the safety and sustainability obligations over the deferral period.</p> <p>Further details of the performance framework are set out on page 89.</p> <p>The overall structure is in line with the incentive principles outlined by the ORR.</p>	<p>Maximum annual opportunity for executive directors is 20 per cent of base salary.</p>	<p>All employees are eligible to participate in an incentive plan. The corporate element of the bonus scheme has the same measures and targets for all participants, including executive directors, incentivising the achievement of shared objectives for all.</p>

Incentive – performance framework and target setting

Overall framework

For executive directors, the incentive will be based on both a corporate performance scorecard and targets specific to the business unit or area of responsibility for each director. For 2015, it will be weighted equally although the committee retains discretion to adjust the weightings for future years. The corporate performance element of the incentive is based on a balanced scorecard of performance measures which the committee believes is the most appropriate way to reward performance in the range of areas which are most important to Network Rail's stakeholders. In particular the balanced scorecard should strike an appropriate balance between measures which reflect:

- Annual operating performance (for example train performance), and
- Long-term stewardship of the railway (for example delivery of enhancements and renewals).

The current balanced scorecard of performance measures and target ranges (for 2015) is shown on page 76 of the annual remuneration report.

The targets for each measure are determined by the committee at the start of the year. The targets are set to be consistent with the delivery of the overall CP5 regulatory targets, as well as the specific business plans for the year, and are cascaded consistently throughout Network Rail.

For each measure, a target range applies, under which between 0 per cent and 100 per cent of the maximum may pay out based on actual performance against the target range. The target ranges are designed to be stretching and to only deliver a payout where performance is above expectations, with maximum payout requiring exceptional performance.

The committee retains discretion to adjust the calibration of the corporate scorecard (in terms of the measures and weightings) each year to appropriately reflect the specific priorities of the business or of a particular individual in that year. Targets specific to the business unit or area of responsibility will be set by the committee at the start of each year. Such targets will reflect specific objectives for the business unit or area of responsibility and will be aligned with key business objectives assigned to support the long-term delivery of overall CP5 regulatory targets.

Overall business performance

In addition, the committee has an overriding discretion to make adjustments to reflect its assessment of overall business performance in the year, including safety. This takes into account a range of factors including the ORR's annual assessment of Network Rail's performance, and reports from the audit and risk and safety, health and environment committees.

For the avoidance of doubt, in the event of a serious safety incident during the year which impacts passengers, workforce, or the public, for which Network Rail was responsible, no Incentive would normally be payable to any executive director in respect of that year.

Safety and sustainability obligations

The payment of any deferred amount is subject to the committee's confirmation that the safety and sustainability obligations described below have been met. In the event that the obligations are not met, the committee may reduce the value of the deferred amount (including to zero), or impose further conditions which must be fulfilled prior to payment.

Details of how the committee had undertaken the assessment prior to payment of an award would be disclosed in the relevant annual remuneration report.

- **Safety.** In the event of a serious safety incident over the deferral period which impacts passengers, workforce, or the general public, for which Network Rail was responsible, the committee has discretion to reduce the deferred amount(s) which may be payable to an executive director (including to zero).
- **Sustainability of business performance.** The committee must confirm that performance delivered in the performance year has been appropriately sustained over the deferral period. No specific targets would apply for this assessment, but the committee would consider the following indicators:
 - Material downturn in a metric. The committee's assessment of the extent to which performance in each of the metrics under the balanced scorecard (including safety) has been appropriately sustained in the years following the performance year. A consistent and material downturn in performance for a particular metric following the performance year may indicate performance has not been appropriately sustained.
 - Undermining long-term stewardship. Determination by the committee that annual operating performance targets have not been achieved as a result of actions which could undermine effective stewardship and performance of the railway network over the long term.
 - Overall CP5 consistency. Incentive payouts in respect of CP5 which, in aggregate, are consistent with overall performance in CP5 against the regulatory objectives.

Remuneration policy continued

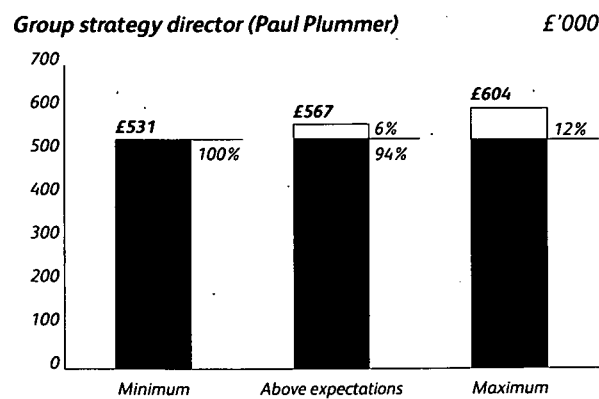
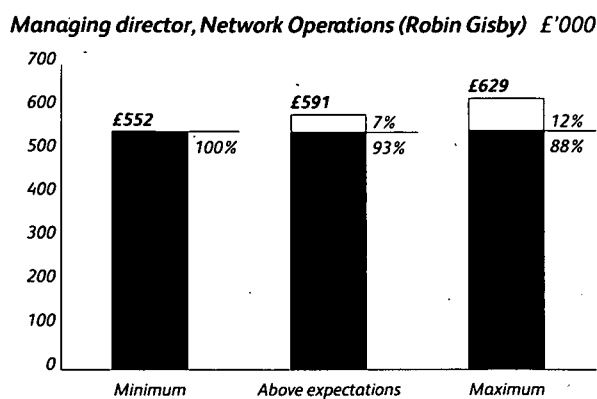
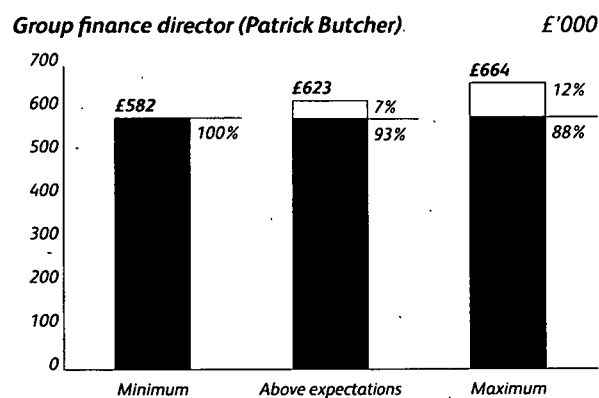
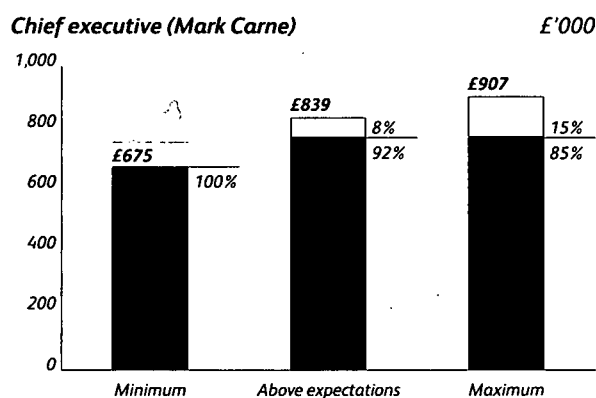
- Other circumstances:

- A material misstatement of the company's audited financial results and disclosed operational performance
- A material failure of risk management, or a failure to comply with obligations set out in applicable contractual agreements (including the network licence, the Access Agreements or other relevant contracts)
- Gross misconduct
- Serious reputational damage to the company as a result of the participant's misconduct or otherwise.

Illustration of remuneration policy

The reporting regulations require the inclusion of charts which illustrate the application of the Remuneration Policy set out in the Policy Table for executive directors by showing the potential value of the annual remuneration package under three scenarios. The assumptions used in the charts below are:

- 'Minimum' shows fixed pay only (base salary effective as at 1 July 2014 and the annualised disclosed pension / benefits for 2014)
- 'Above expectations' includes fixed pay and 50 per cent of maximum payout under the Incentive i.e. 10 per cent of salary
- 'Maximum' includes fixed pay and maximum payout under the Incentive (i.e. 20 per cent of salary).



- Incentive
- Fixed pay (salary, benefits, pension)

Legacy arrangements

The committee reserves the right to make any remuneration payments and payments for loss of office (including exercising any discretions available to it in connection with such payments) notwithstanding that they are not in line with the policy set out above where the terms of the payment were agreed (i) before the policy came into effect or (ii) at a time when the relevant individual was not a director of the company and, in the opinion of the committee, the payment was not in consideration for the individual becoming a director of the company. For these purposes 'payments' includes the committee satisfying awards of variable remuneration and the terms of the payment are 'agreed' at the time the award is granted.

Approach to recruitment remuneration

New executive directors would be appointed on to the remuneration package described in the policy table. The approach which the committee would take to each of the components is as follows:

- Salary would be set at a level which positions the remuneration package in the market competitive range taking into account the skills and experience of the individual, the scope and responsibilities of the role. The committee would seek to pay no more than it believes is necessary to secure the calibre of individual needed to lead a business of the scale and complexity of Network Rail, in line with the overall obligation to ensure value for money for our funders.
- Benefits would comprise those shown in the policy table. Where the committee considers it appropriate for the circumstances of the individual (for example, if relocation is required), reasonable travel or relocation related benefits may be provided. Such benefits would normally be limited to an initial period only.
- Participation in the Network Rail pension schemes would be in line with all employees. A cash supplement of up to 10 per cent of salary above the earnings cap may also be included, in line with the policy table.
- Eligibility to participate in the Incentive, up to a maximum of 20 per cent of salary annually in line with the policy table. Participation in the year of appointment would normally be on a pro-rata basis to reflect the period worked in the relevant year. Any pro-rata participation would be qualified by an assessment of the realistic impact a new joiner could make in the year of appointment.

Where a newly appointed executive director forfeits outstanding incentive awards at a previous employer as a result of appointment to Network Rail, the committee may consider offering replacement awards to facilitate recruitment. Any replacement awards would be deferred over a number of years (taking into account the time horizons of the forfeited awards) and may be made conditional on individual and/or Network Rail performance. Under no circumstances would an immediate non-performance related 'golden hello' payment be made.

Service agreements

Executive directors have service agreements which can be terminated by the company or the director by giving six months' notice. This applies to all current executive directors and would normally be applied as the policy for future appointments.

Name	Effective date of agreement	Notice period (from executive director and from Company)
Mark Carne	6 January 2014	6 months
Patrick Butcher	20 April 2009	6 months
Robin Gisby	1 October 2008	6 months
Paul Plummer	1 October 2008	6 months

The company may terminate employment by making a payment in lieu of notice which would not exceed six months' salary. Each service agreement contains an express provision requiring the departing executive director to mitigate their loss. Network Rail would have regard to that duty and contractual requirement on a case by case basis when assessing the appropriate level of compensation which may be payable, including using phased payments.

Remuneration policy continued

Policy on payment for loss of office

Where an executive director leaves employment, the committee's approach is to minimise the cost to Network Rail and to ensure that any incentive payments appropriately reflect performance.

As described above, any payment in lieu of notice would be limited to six months' salary and subject to mitigation. No other termination payments would be made.

There is no entitlement to an Incentive award in respect of the year of cessation of employment.

Outstanding awards under the Incentive will be determined by the rules of the plan. If an individual leaves employment during the deferral period, the deferred amount will normally lapse immediately. If the committee determines that the individual is a good leaver for one of the reasons described below, the award will not lapse but will continue to the original payment date and will remain subject to the committee's assessment of the safety and sustainability obligations in respect of that award. The committee retains discretion to undertake the assessment and make the payment at an earlier date if appropriate (for example on death). The committee also retains discretion to reduce the value of the deferred award to reflect the portion of the deferral period which has elapsed on cessation.

CP5 Incentive – good leaver definition

- Disability, injury or ill-health
- Death in service
- Redundancy
- Retirement (with the agreement of the Company), or
- Any other reason at the discretion of the committee (including a participant leaving by mutual agreement).

Chairman and non-executive directors

Terms of appointment

The chairman and non-executive directors are appointed for a three year term, which can be extended by mutual consent. Termination without compensation requires six months' written notice by the director or the company.

Policy table for the chairman and non-executive directors

<i>Approach</i>	<i>Remuneration</i>
Fees are normally reviewed bi-annually and, with the exception of the fee for the chairman (which is determined by the committee), are set by the executive directors to attract individuals with the appropriate range of skills and experience.	The chairman receives a single fees which reflects all board and committee duties. The non-executive directors receive a basic fee and may also receive supplementary fees for other board duties, such as chairmanship of a committee or the senior independent director role.
In determining the level of fees their duties and responsibilities are considered, together with the level of time commitment required in preparing for and attending meetings.	The chairman and non-executive directors do not receive any benefits nor do they participate in any incentive plan, or in any pension arrangements. The chairman and non-executive directors do not receive benefits nor do they participate in Network Rail's pension or incentive arrangements. Reimbursement of expenses reasonably and properly incurred in attending meetings of the board or otherwise in the performance and discharge of their duties and responsibilities.

The remuneration package for a newly appointed chairman or non-executive director would be in line with the structure set out above.



Michael O'Higgins

Chairman, remuneration committee

11 June 2014

Directors' report

Certain directors' report disclosures have been made in the strategic report and governance sections so as to increase their prominence. These disclosures include those relating to the review of the group's business during the year, future developments, greenhouse gas emissions, financial instruments and employee development, diversity and equality.

Directors

The directors who served throughout the year and held office at the date of signing the financial statements are detailed on pages 48 to 50.

Political donations

In line with company policy, no donations to political parties were made during the year (2013: £nil).

The company needs to work closely with all types of community representatives and has a significant amount of contact with a wide range of elected representatives (including members of Parliament, Scottish Parliament, London Assembly and Welsh Assembly) as well as with non-governmental organisations, pressure groups and campaigning organisations. Meetings are held to discuss both the company's issues and the issues of passengers and freight users on a national and regional scale.

Opportunity is also taken each year to explain to elected representatives the company's business plans, performance and significant developments within the business.

Investing in research and development

Technology and innovation is fundamental to the company's success in CP5 and beyond and 'a technology enabled future' is one of the company's 10 strategic themes. Further detail can be found on page 18.

During the year the company charged £1m to the income statement (2013: £1m) on research and development. Other costs relating to significant development work have been capitalised in property, plant and equipment.

Statement of directors' responsibilities

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

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

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and the group and enable them to ensure that the financial statements and the directors' remuneration report comply with the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation. 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.

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

Each of the directors, whose names and functions are listed on pages 48 to 50 confirm that, to the best of their knowledge:

- The group financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the group
- The directors' report contained in the annual report includes a fair review of the development and performance of the business and the position of the group, together with a description of the principal risks and uncertainties that it faces.

Directors' report continued

Disclose of information to the independent auditors

Each of directors at the date of approval of this report confirms that:

- So far as the director is aware, there is no relevant audit information of which the company's auditor is unaware
- The director has take all steps that he or she ought to have taken as a director in order to make the director aware of any relevant audit information and to establish that the company's auditor is aware of that information.

The directors' report has been signed on behalf of the board of the company



Suzanne Wise
Group general counsel and
company secretary

11 June 2014

Financial statements and notes

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Independent auditors' report

to the members of Network Rail Limited

Report on the financial statements

Our opinion

In our opinion:

- the financial statements, defined below, give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2014 and of the group's profit and the group's and the parent company's cash flows for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

This opinion is to be read in the context of what we say in the remainder of this report.

What we have audited

The group financial statements and parent company financial statements (the "financial statements"), which are prepared by Network Rail Limited, comprise:

- the group and parent company balance sheet as at 31 March 2014;
- the group income statement and statement of comprehensive income for the year then ended;
- The group and parent company statement of cash flows for the year then ended;
- the group statement of changes in equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Certain disclosures required by the financial reporting framework have been presented elsewhere in the annual report and accounts (the "Annual Report"), rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). 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 the 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 Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Overview of our audit approach

Materiality

We set certain thresholds for materiality. These helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Network Rail Limited is a regulated company whose returns are driven off its Regulatory Asset Base and determined by the Office of Rail Regulation (ORR). Accordingly we believed that an asset based measure was the most appropriate benchmark to use in determining materiality for the group financial statements. Based on our professional judgement, we determined materiality for the group financial statements as a whole to be £50 million. This represents approximately 0.1 per cent of total assets.

We agreed with the audit and risk committee that we would report to them misstatements identified during our audit above £2.5 million as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Overview of the scope of the audit

The group is structured across ten geographic routes which make up the UK's railway network, together with infrastructure projects, asset management, property, treasury and tax. From a legal perspective, the majority of operations are within Network Rail Infrastructure Limited. The treasury business is in a separate legal entity, Network Rail Infrastructure Finance PLC, and there are further small legal entities including a consultancy business and a company that manages the maintenance of non-owned stations. The group is a consolidation of these entities.

Accordingly, based on size and risk characteristics, we determined that our audit work would be performed on the complete financial information of Network Rail Infrastructure Limited and Network Rail Infrastructure Finance PLC. This work was undertaken by the group audit team with no component auditor involvement. This work covered substantially all of the group's assets and pre-tax profits and, together with the procedures performed at the group level, gave us the evidence we needed for our opinion on the group financial statements as a whole.

Areas of particular audit focus

In preparing the financial statements, the directors made a number of subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We primarily focused our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

In our audit, we tested and examined information, using sampling and other auditing techniques, to the extent we considered necessary to provide a reasonable basis for us to draw conclusions. We obtained audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

We considered the following areas to be those that required particular focus in the current year. This is not a complete list of all risks or areas of focus identified by our audit. We discussed these areas of focus with the audit and risk committee. Their report on those matters that they considered to be significant issues in relation to the financial statements is set out on page 67.

Independent auditors' report continued

to the members of Network Rail Limited

Area of focus

Valuation of railway network and the impact of regulatory requirements on the valuation

The railway network fixed asset balance is revalued at each reporting date to its fair value on a discounted cash flow basis. A major part of our audit effort was therefore focussed on the group's accounting for capital expenditure and the inputs to and operation of the fair value calculation:

1. Capital expenditure

The group has a large capital expenditure programme which, due to the construction nature of the business, is based on the cost of work done on each project.

Furthermore, due to the regulatory nature of the industry, each project attracts different types and levels of funding and has specific characteristics. The cost of work done represents fixed asset additions.

2. The year end fair value calculation

The discounted cash flow model is complex and a number of the inputs involve significant estimates and judgements made by management.

These estimates and judgements were particularly significant because it was the end of the fourth regulatory control period ("CP4"). The year end valuation is affected by the assessment of any deferrals, efficiencies and inefficiencies in Network Rail's capital expenditure together with its performance against its regulator set delivery plan for CP4 and any penalties or adjustments that the ORR may impose for non-delivery. This is because the model is based on a discounted cash flow and if the ORR were to impose penalties on Network Rail or to disallow certain expenditure from earning a return due to deferrals or inefficiencies then this would need to be modelled in the cash flow.

Additionally, on the basis that the railway network valuation is forward looking, it is affected by an assessment of estimates on the expected out or underperformance in the next control period ("CP5") with consideration to the CP5 delivery plan. As Network Rail is five years from the end of CP5, a significant level of estimation is required.

How the scope of our audit addressed the area of focus

1. Capital expenditure

We tested controls over the group's Governance for Railway Investment Projects ('GRIP') process which is the mechanism for determining the status of each capital project.

We performed testing over Network Rail's purchase to payables cycle with a particular focus on capital expenditure, work done in respect of ongoing projects and the value of capital accruals. We also tested the classification of spend as either capital or operating and the recognition of costs on appropriate projects.

We tested controls over the booking of costs to projects and for selected projects, supplemented this with tests of detail over costs booked to projects, with a particular focus on those close to the end of the year and therefore the control period.

We evaluated Network Rail's process for ensuring accuracy of cut-off and accruals at the year end.

2. The year end fair value calculation

We checked the mathematical accuracy of the discounted cash flow valuation model and the consistency of the financial information with the underlying books and records.

We also assessed the reasonableness of the key judgements and estimates behind the inputs to the model in respect of both the close out of CP4 and the implications of the new control period which impact the valuation.

We then held discussions with Arup, the regulator's independent reporter, on the findings of their work in respect of efficiency measures in CP4 and checked how they were reflected in the valuation. We have also held discussions directly with the ORR regarding the closing out of Network Rail's delivery against the CP4 plan again checking that this was appropriately reflected in the financial statements.

We read the ORR's final determination of Network Rail's outputs and funding for CP5 and considered any new regulatory requirements and the impact that these had on the railway network valuation.

We assessed the reasonableness of the key judgements and estimates in respect of both the close out of CP4 and the implications on CP5 which impact the valuation.

Finally we assessed the adequacy of the disclosures in the financial statements around the valuation process and the related assumptions and judgements.

Area of focus	How the scope of our audit addressed the area of focus
<p>Risk of fraud in Revenue recognition</p> <p>ISAs (UK & Ireland) presume there is a risk of fraud in revenue recognition, whether caused by fraud or error.</p> <p>We considered each revenue stream and determined that the risk of fraud in revenue recognition was only significant in respect of the group's property rental income, in particular the accuracy and timing of revenue recognition against the contractual terms of the lease.</p>	<p>We evaluated the relevant IT systems and tested the internal controls over the completeness, accuracy and timing of revenue recognised in the financial statements.</p> <p>We used data analysis to test the flow of transactions in the revenue cycle and targeted a number of non-standard/unusual revenue transactions to determine whether these were appropriate and in the ordinary course of business. For a sample of properties, we tested that the amounts invoiced were in accordance with the contractual terms of the lease.</p> <p>We also tested journal entries posted to revenue accounts to identify unusual or irregular items.</p>
<p>Risk of management override of internal controls</p> <p>ISAs (UK & Ireland) require that we consider this.</p>	<p>We assessed the overall control environment of the group, including the arrangements for staff to "whistle-blow" inappropriate actions, and interviewed senior management and the group's Internal Audit function.</p> <p>We examined the significant accounting estimates and judgements relevant to the financial statements for evidence of bias by the directors that may represent a risk of material misstatement due to fraud.</p> <p>We tested key reconciliations and also tested manual journal entries, in particular any manual journals made between projects and those to "costs of work done" and therefore impacting capital spend and accruals.</p>

Independent auditors' report continued

to the members of Network Rail Limited

Going concern

The directors have voluntarily complied with Listing Rule 9.8.6(R)(3) of the Financial Conduct Authority and provided a statement in relation to going concern, set out on page 108, required for companies with a premium listing on the London Stock Exchange (as set out in Network Rail's license conditions).

The directors have requested that we review the statement on going concern as if the parent company were a premium listed company. We have nothing to report having performed our review.

As noted in the Statement of directors' responsibilities, the directors have concluded that it is appropriate to prepare the financial statements using the going concern basis of accounting. The going concern basis presumes that the group and parent company have adequate resources to remain in operation, and that the directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the group's and parent company's ability to continue as a going concern.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Opinion on additional disclosures

Directors' remuneration report

The parent company voluntarily prepares a directors' remuneration report in accordance with the provisions of the Companies Act 2006 (as set out in Network Rail's license conditions). The directors have requested that we audit the part of the directors' remuneration report specified by the Companies Act 2006 to be audited as if the parent company were a quoted company.

In our opinion the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- 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.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility.

Corporate governance statement

The directors have chosen voluntarily to comply with the UK Corporate Governance Code ("the Code") as if the parent company were a premium listed company. On page 68 of the Annual Report, as required by the Code Provision C.1.1, the directors state that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the group's and parent company's performance, business model and strategy. On page 67, as required by C.3.8 of the Code, the audit and risk committee has set out the significant issues that it considered in relation to the financial statements, and how they were addressed. Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

- the statement given by the directors is materially inconsistent with our knowledge of the group and parent company acquired in the course of performing our audit; or
- the section of the Annual Report describing the work of the audit and risk committee does not appropriately address matters communicated by us to the audit and risk committee.

We have no exceptions to report arising from this responsibility.

Other information in the Annual Report
Under ISAs (UK & Ireland) we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the group and parent company acquired in the course of performing our audit; or
- is otherwise misleading.

We have no exceptions to report arising from this responsibility.

Matters on which we have agreed to report by exception

Corporate governance statement

The parent company's voluntary Corporate Governance Statement includes details of the parent company's compliance with the UK Corporate Governance Code. The directors have requested that we review the parts of the Corporate Governance Statement relating to the parent company's compliance with the nine provisions of the UK Corporate Governance Code specified for auditor review by the Listing Rules of the Financial Conduct Authority as if the parent company were a premium listed company. We have nothing to report having performed our review.

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' responsibilities set out on page 93, 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 ISAs (UK & 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.



Jonathan Hook

Senior Statutory Auditor

for and on behalf of
PricewaterhouseCoopers LLP
Chartered Accountants and
Statutory Auditors

London
11 June 2014

Income statement

for the year ended 31 March 2014

	Notes	Results pre debt and derivative revaluations 2014 Group £m	Debt and derivative revaluations 2014 Group £m	2014 Group £m	2013 Group restated* £m
Revenue	3	6,333	–	6,333	6,197
Net operating costs	4	(4,332)	–	(4,332)	(3,990)
Operating profit		2,001	–	2,001	2,207
Property revaluation movements and profits on disposal		96	–	96	(3)
Total profit from operations	5	2,097	–	2,097	2,204
Investment revenue	7	20	–	20	19
Other gains and losses	8	–	304	304	(43)
Finance costs	9	(1,386)	–	(1,386)	(1,433)
Profit before tax		731	304	1,035	747
Tax	10	282	(61)	221	(70)
Profit after tax for the year		1,013	243	1,256	677

* The comparatives have been restated for adoption of IAS 19 (Revised) 'Employee Benefits'

Under section 408 of the Companies Act 2006 the group has elected to take the exemption with regard to disclosing the company income statement. The company's result for the year was £nil (2013: £nil).

Statement of comprehensive income

for the year ended 31 March 2014

	Notes	2014 Group £m	2013 Group restated* £m
Profit for the year		1,256	677
Other comprehensive (expense)/income:			
Items that will not be reclassified to profit or loss			
Loss on revaluation of the railway network	12	(1,813)	(352)
Actuarial gain/(loss) on defined benefit pension schemes	26	140	(550)
Tax relating to components of other comprehensive income	22	320	268
Total items that will not be reclassified to profit or loss		(1,353)	(634)
Items that may be reclassified to profit or loss			
Gain on movement in fair value of cash flow hedge derivatives		172	71
Reclassification of balances in the hedging reserve to the income statement		218	18
Tax relating to components of other comprehensive income	22	(124)	(36)
Total items that may be reclassified to profit or loss		266	53
Other comprehensive expense for the year		(1,087)	(581)
Total comprehensive income for the year		169	96

* The comparatives have been restated for adoption of IAS 19 (Revised) 'Employee Benefits'.

Statement of changes in equity

for the year ended 31 March 2014

Group	Revaluation reserve £m	Other reserve* £m	Hedging reserve £m	Retained earnings £m	Total £m
Balance at 31 March 2012	3,123	249	(241)	4,786	7,917
Profit for the year – restated	–	–	–	677	677
Other comprehensive income/(loss) for the year:					
Impact of change in tax rate	55	–	(10)	(6)	39
Revaluation of the railway network	(352)	–	–	–	(352)
Transfer of deemed cost depreciation from revaluation reserve	(27)	–	–	27	–
Decrease in deferred tax liability on the railway network	91	–	–	(6)	85
Actuarial loss on defined benefit pension schemes – restated	–	–	–	(550)	(550)
Deferred tax on actuarial loss – restated	–	–	–	134	134
Increase in fair value of hedging derivatives	–	–	71	–	71
Deferred tax on all hedging reserve movements/retained earnings	–	–	(26)	–	(26)
Reclassification of balances in hedging reserve to the income statement	–	–	18	–	18
Total comprehensive income/(loss) for the year:	(233)	–	53	276	96
Balance at 31 March 2013	2,890	249	(188)	5,062	8,013
Profit for the year	–	–	–	1,256	1,256
Other comprehensive income/(loss) for the year:					
Impact of change in tax rate	159	–	(9)	(17)	133
Revaluation of the railway network	(1,813)	–	–	–	(1,813)
Transfer of deemed cost depreciation from revaluation reserve	(84)	–	–	84	–
Decrease in deferred tax liability on the railway network	228	–	–	(17)	211
Actuarial gain on defined benefit pension schemes	–	–	–	140	140
Deferred tax on actuarial gain	–	–	–	(33)	(33)
Increase in fair value of hedging derivatives	–	–	172	–	172
Deferred tax on all hedging reserve movements/retained earnings	–	–	(115)	–	(115)
Reclassification of balances in hedging reserve to the income statement	–	–	218	–	218
Total comprehensive income/(loss) for the year:	(1,510)	–	266	1,413	169
Balance at 31 March 2014	1,380	249	78	6,475	8,182

* Other reserves of £249m (2013: £249m) include the vesting reserve on privatisation.

There has been no movement in the current or prior year affecting the statement of changes in equity for the company.

Balance sheets

at 31 March 2014

	Notes	2014 Group £m	2013 Group £m	2014 Company £m	2013 Company £m
Assets					
Non-current assets					
Intangible assets	11	68	69	-	-
Property, plant and equipment – the railway network	12	49,833	46,411	-	-
Investment property	13	856	751	-	-
Derivative financial instruments	20	637	697	-	-
Finance lease receivables	16	1	3	-	-
Other receivables	17	135	-	-	-
Interest in joint ventures	14	27	12	-	-
		51,557	47,943	-	-
Current assets					
Inventories	15	173	157	-	-
Finance lease receivables	16	2	2	-	-
Trade and other receivables	17	915	776	-	-
Current tax assets		4	9	-	-
Derivative financial instruments	20	11	256	-	-
Cash and cash equivalents		1,253	3,506	-	-
		2,358	4,706	-	-
Total assets		53,915	52,649	-	-
Liabilities					
Current liabilities					
Trade and other payables	18	(3,886)	(3,394)	-	-
Borrowings	19	(2,707)	(4,120)	-	-
Derivative financial instruments	20	(277)	(23)	-	-
Provisions	21	(143)	(8)	-	-
		(7,013)	(7,545)	-	-
Net current liabilities		(4,655)	(2,839)	-	-
Non-current liabilities					
Borrowings	19	(31,308)	(29,354)	-	-
Derivative financial instruments	20	(387)	(608)	-	-
Other payables	18	(3,297)	(2,953)	-	-
Retirement benefit obligation	26	(1,237)	(1,267)	-	-
Deferred tax liabilities	22	(2,491)	(2,909)	-	-
		(38,720)	(37,091)	-	-
Total liabilities		(45,733)	(44,636)	-	-
Net assets		8,182	8,013	-	-
Equity					
Revaluation reserve		1,380	2,890	-	-
Other reserve		249	249	-	-
Hedging reserve		78	(188)	-	-
Retained earnings		6,475	5,062	-	-
Total equity		8,182	8,013	-	-

The financial statements on pages 102 to 144 were approved by the board of directors and authorised for issue on 11 June 2014.

They were signed on its behalf by:


Mark Garner
Chief executive


Patrick Butcher
Group finance director

Company registration number: 4402220

Statement of cash flows

for the year ended 31 March 2014

	Notes	2014 Group £m	2013 Group £m	2014 Company £m	2013 Company £m
Cash flows from operating activities					
Cash generated from operations	23	3,771	3,749	–	–
Interest paid		(1,077)	(1,038)	–	–
Income tax received/(paid)		4	(8)	–	–
Net cash generated from operating activities		2,698	2,703	–	–
Investing activities					
Interest received		20	20	–	–
Purchases of property, plant and equipment		(6,263)	(4,693)	–	–
Proceeds on disposal of property		41	39	–	–
Capital grants received		227	137	–	–
Investment in joint ventures		(15)	(6)	–	–
Capital element of finance lease receipts		2	2	–	–
Net cash used in investing activities		(5,988)	(4,501)	–	–
Financing activities					
Repayments of borrowings		(3,975)	(1,203)	–	–
Repayments of obligations under finance leases		–	(1)	–	–
New loans raised		5,104	4,751	–	–
Movement in collateral obligation owed to counterparties		(143)	323	–	–
Cash flow on settlement of non-hedge accounted derivatives		–	(452)	–	–
Net cash generated from financing activities		986	3,418	–	–
Net (decrease)/increase in cash and cash equivalents		(2,304)	1,620	–	–
Cash and cash equivalents at beginning of the year		3,506	1,886	–	–
Cash and cash equivalents at end of the year		1,202	3,506	–	–
Cash and cash equivalents comprise:					
Short-term bank deposits, commercial paper and money market deposits		1,253	3,506	–	–
Bank overdrafts		(51)	–	–	–
		1,202	3,506	–	–

Notes to the financial statements

for the year ended 31 March 2014

1. General information

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

The company registration number is 4402220.

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

The company's principal activities are detailed in the 'What we do' section on pages 2 and 3.

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

2. Significant accounting policies

Basis of accounting

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

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

In preparing the consolidated financial statements, comparative amounts have been restated for the adoption of IAS 19 (Revised) *Employee Benefits*. The financial impact of the restatement is set out in note 26.

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

Presentation of the income statement: exceptional debt and derivative revaluations

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

Adoption of new and revised standards

The following accounting standards and amendments to accounting standards have been adopted by the group for the first time for the financial year beginning on 1 April 2013 and have an impact on the group.

(i) The June 2011 amendment to IAS 1 *Financial Statement Presentation*, whereby other comprehensive income or loss is now grouped on the basis of whether such income or loss is potentially reclassifiable to profit or loss.

(ii) IAS 19 (as revised in June 2011) *Employee Benefits*. See note 26 for further information.

(iii) The amendment to IFRS 7 *Financial Instruments: Disclosures* on financial asset and financial liability offsetting. See note 25 for further information.

(iv) IFRS 13 *Fair Value Measurement*. This standard provides a single source of fair value measurement and disclosure requirements for use across IFRS. The implementation of this standard did not lead to a significant change in the fair value measurement applied by the group. See note 25 for the additional fair value hierarchy disclosures provided.

The group has yet to assess the full impact of IFRS 9 *Financial Instruments* which includes requirements for recognition and measurement, derecognition and hedge accounting. The standard has been issued, but has not been applied to these financial statements as it is not yet effective.

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

Notes to the financial statements continued

2. Significant accounting policies continued

Going concern

The group's business activities, together with the factors likely to affect its future development, performance and position are set out in the 'What we do' section on pages 2 and 3, and 'What we want to be' on pages 12 and 13. The financial position of the group, its cash flows, liquidity position and borrowing facilities are described in the group finance director's review on pages 40 to 44. In addition, Note 25 to the accounts includes the group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit, liquidity and foreign exchange risk.

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

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

Basis of consolidation

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

Revenue recognition

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

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

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

Grants

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

Leasing

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

The group as lessor

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

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

2. Significant accounting policies continued

The group as lessee

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

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

Foreign currencies

Monetary assets and liabilities expressed in foreign currencies are translated into sterling at the exchange rates prevailing at the balance sheet date. Foreign currency amounts are initially recorded at the exchange rates prevailing on the dates of the transactions. 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.

Borrowing costs

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

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

Operating profit

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

Retirement benefit costs

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

For the defined benefit schemes, the cost of providing benefits is determined using the projected unit credit method, with full actuarial valuations being carried out at least every three years and updates to these valuations carried out in intervening years. The current service cost and plan administration expenses are recognised as an operating expense in the consolidated income statement.

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

The net interest cost is the charge in the year on the net defined benefit liability. The charge reflects the passage of time and is recognised as a finance cost in the income statement.

Past service cost and credits are recognised immediately in the consolidated income statement.

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.

Notes to the financial statements continued

2. Significant accounting policies continued

Tax

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

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

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

Deferred tax liabilities are recognised for all taxable temporary differences. 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 accounted for within equity.

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. This valuation is carried out twice a year 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 weighted average remaining useful economic life. The estimated weighted average remaining useful economic life of the network is currently 30 years (2013: 30 years). The remaining useful economic lives of network assets are estimated annually, with external verification of the valuation and asset lives carried out where required.

Investment property

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

Research and development

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

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

Intangible assets

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

2. Significant 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 group's balance sheet when the group becomes party to the contractual provisions of the instrument.

Financial assets

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

Financial assets at FVTPL

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

A financial asset is classified as held for trading if:

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

Impairment of financial assets

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

The carrying amount of the financial asset is 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.

Cash and cash equivalents

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

Joint ventures

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

Financial liabilities

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

Notes to the financial statements continued

2. Significant accounting policies continued

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 neither designated nor effective as a hedging instrument.

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

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

Debt

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

Trade payables

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

Derivative financial instruments and hedge accounting

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

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

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

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

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

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

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

Fair value hedges

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

Cash flow hedges

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

2. Significant accounting policies continued

Provisions

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

Critical accounting judgements and key sources of uncertainty

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

(ii) Investment property – an element of the investment property portfolio valuation is determined using the Beacon method. Jones Lang LaSalle provided their assessment of yields for 16 properties in the portfolio. These are then used to produce income multipliers and applied to the rental streams from each of the individual properties in the portfolio to form an overall valuation. Further details are set out in Note 13.

(iii) Retirement benefit obligations – the group recognises and discloses its retirement benefit obligation in accordance with the measurement and presentational requirement of IAS 19 (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 26. The total contribution rate payable under the Railway Pension Scheme (RPS) and the Career Average Revalued Earnings (CARE) scheme is normally split in the proportion 60:40 between the group and the members, respectively. The group reflects its share of the contribution in the financial statements.

3. Revenue

	2014 Group £m	2013 Group £m
Franchised track access and grant income	6,020	5,893
Freight revenue	52	48
Property rental income	238	233
Other income	23	23
Revenue for the year	6,333	6,197

The net effect of the performance regimes on the results of the group was a net loss of £218m (2013: net loss of £109m). Rebates of £110m and £32m were paid to the Department for Transport and Transport Scotland respectively.

4. Net operating costs

	2014 Group £m	2013 Group restated* £m
Employee costs (see Note 6)	1,910	1,789
Own costs capitalised	(739)	(653)
Other external charges (including infrastructure maintenance costs)	1,873	1,686
Other operating income and recoveries	(233)	(242)
Net operating costs before depreciation	2,811	2,580
Depreciation and other amounts written off non-current assets	1,603	1,491
Capital grants amortised	(82)	(81)
Net operating costs	4,332	3,990

* The comparatives have been restated for adoption of IAS 19 (Revised) 'Employee Benefits'

Other external charges include a financial penalty of £77m arising from an order made by the ORR in respect of the 2014 long distance punctuality target.

Notes to the financial statements continued

5. Profit from operations

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

	2014 Group £m	2013 Group £m
Research and development costs expensed	1	1
Amortisation of intangible assets	1	1
Profit on sale of properties	(37)	(36)
(Increase)/decrease in the fair value of investment properties	(59)	39
Cost of inventories recognised as an expense	205	124
Write downs of inventories recognised as an expense	3	2

Amounts payable to auditors

Fees payable to the company's auditors for the audit of the company and consolidated financial statements	0.5	0.4
Fees payable to the company's auditors for audit related services		
– The audit of the company's subsidiaries	0.1	0.1
– Regulatory accounts audit and interim review	0.1	0.1
	0.7	0.6

Fees payable to the company's auditors for non-audit related services

– Consulting work in respect of the ORBIS project	–	0.4
Total non-audit fees	–	0.4
Total amounts payable to auditors	0.7	1.0

6. Employee costs

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

	2014 Group Number	2013 Group Number
Management and operation of the railway	35,141	35,190

	2014 Group £m	2013 Group restated* £m
Their aggregate remuneration comprised:		
Wages and salaries	1,584	1,503
Social security costs	151	145
Defined contribution pension costs (see Note 26)	13	12
Defined benefit pension costs – current service costs (see Note 26)	162	129
Total employee costs	1,910	1,789

* The comparatives have been restated for adoption of IAS 19 (Revised) 'Employee Benefits'

The executive directors are considered to be key management personnel. Details of their remuneration is included within the directors' remuneration report.

7. Investment revenue

	2014 Group £m	2013 Group £m
Interest receivable on investments and deposits	20	19
	20	19
Investment revenue earned on financial assets analysed by category of asset, is as follows:		
	2014 Group £m	2013 Group £m
Loans and receivables (including cash and bank balances)	20	19
	20	19

8. Other gains and losses

	2014 Group £m	2013 Group £m
Net ineffectiveness arising from cash flow hedge accounting	6	(5)
Fair value (loss)/gain on fair value hedges	(540)	308
Fair value gain/(loss) on carrying value of fair value hedged debt	540	(304)
Gain arising from fair value hedge accounting	–	4
Net decrease in fair value of non-hedge accounted debt	54	3
Gain/(loss) on derivatives not hedge accounted	244	(45)
Gain/(loss) arising from non-hedge accounting	298	(42)
Total other gains/(losses)	304	(43)

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

The movements in the hedged risk adjustment on fair value hedged debt, the movement in fair value of debt designated as fair value through profit and loss and exchange differences on retranslation of foreign currency debt that form part of the above total other gains and losses are in relation to debt issuances disclosed in Note 19.

Debt and derivative revaluations

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

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

9. Finance costs

	2014 Group £m	2013 Group restated* £m
Interest on bank loans and overdrafts	21	37
Interest on bonds issued under the Debt Issuance Programme	1,214	1,255
Defined benefit pension interest cost	54	32
Other interest	241	218
Total borrowing costs	1,530	1,542
Less: capitalised interest	(144)	(109)
Total finance costs	1,386	1,433

* The comparatives have been restated for adoption of IAS 19 (Revised) 'Employee Benefits'

Borrowing costs are included in the costs of qualifying assets to the extent that the asset is financed by the group. The average rate used during the year was 4.4 per cent (2013: 4.6 per cent).

Notes to the financial statements continued

10. Tax

	2014 Group £m	2013 Group restated* £m
Current tax:		
Corporation tax charge	4	11
Less advance corporation tax set-off	(3)	(4)
Corporation tax liability	1	7
Adjustments in respect of prior years	–	–
Total current tax	1	7
Deferred tax:		
Current year charge	233	146
Effect of rate change	(220)	(83)
Adjustments in respect of prior years	(235)	–
Total deferred tax	(222)	63
Total tax	(221)	70

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

	2014 Group £m	2013 Group restated* £m
Profit before tax	1,035	747
Tax at the UK corporation tax rate of 23 per cent (2013: 24 per cent)	238	180
Adjustments in respect of prior years	(235)	–
Effect of rate change	(220)	(83)
Income not subject to tax	(1)	(23)
Advance corporation tax previously written off	(3)	(4)
Tax charge for the year	(221)	70

* The comparatives have been restated for adoption of IAS 19 (Revised) 'Employee Benefits'

In addition to the amounts charged to the income statement, deferred tax relating to the revaluation of the railway network amounting to a credit of £387m including the impact of the rate change (2013: £140m) has been credited directly to equity. Movements on the hedging reserve amounted to a debit of £124m including the impact of the rate change (2013: £36m). Movements in equity relating to retirement benefit obligations amounted to a debit of £67m including the impact of the rate change (2013: £134m).

Deferred tax will be realised or settled after 1 April 2015 and is calculated at a rate of 20 per cent (2013: 23 per cent).

UK corporation tax is calculated at 23 per cent (2013: 24 per cent). Further reductions to the UK tax rate have been announced and substantively enacted and will reduce the rate to 21 per cent by 1 April 2014 and 20 per cent by 1 April 2015.

The group have £30m (2013: £32m) of surplus advance corporation tax carried forward (including a release in relation to the prior year). No deferred tax asset has been provided in respect of this amount.

11. Intangible assets

Group	Concession £m
Cost	
At 1 April 2012, 31 March 2013 and 31 March 2014	78
Accumulated amortisation	
At 1 April 2012	(8)
Charge for the year	(1)
At 31 March 2013	(9)
Charge for the year	(1)
At 31 March 2014	(10)
Carrying amount	
At 31 March 2014	68
At 31 March 2013	69

The intangible assets above relate to the concession to run the operations, maintenance and renewal business of the Channel Tunnel Rail Link, and are held by the wholly owned group company Network Rail (High Speed) Limited.

Intangible assets are being amortised over 83 years, to 2086. Amortisation is charged to net operating costs in the income statement.

12. Property, plant and equipment – the railway network

Group	£m
Valuation	
At 1 April 2012	43,112
Additions	5,050
Transfer from investment property	92
Depreciation charge for the year	(1,491)
Revaluation in the year	(352)
At 31 March 2013	46,411
Additions	6,873
Transfer to investment property	(35)
Depreciation charge for the year	(1,603)
Revaluation in the year	(1,813)
At 31 March 2014	49,833

Given the interdependency of the assets comprising the railway network, the group has concluded that the railway network is a single class of asset. The railway network is carried at its fair value, which is measured as the estimated future cash flows that are expected to be generated in perpetuity, discounted at a pre-tax rate of return, as set by the independent rail regulator, (the ORR), in its 'Final determination for Network Rail's outputs and funding 2014-19'. This rate reflects the risks and opportunities that exist in the regulated market for railway infrastructure assets and equates to the cost of capital for this market.

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

As there is no active market in railway infrastructure assets, the group has derived the fair value of the railway network using an income approach. The income approach assesses the discounted future cash flows that would be generated by the railway network 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.

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

Notes to the financial statements continued

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

The RAB is used by the ORR to set Network Rail's charges to customers and is a proxy for the present value of future cash flows. Annual income (receivable as track access charges and the network grant) comprises three elements:

- a) Efficient operating and maintenance costs – paid to Network Rail as they are expected to be incurred
- b) RAB amortisation – capital expenditure is added to the RAB as incurred in order to spread the cost to customers and stakeholders of investment in the railway network over many years. The ORR allows Network Rail to recover these costs through amortisation of the RAB
- c) Allowed return – calculated by applying the rate of return permitted by the ORR (based on its assessment of the market's cost of capital) to the RAB balance. The ORR has determined that for CP5 it will not provide Network Rail with a full market cost of capital. The ORR believes 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 has confirmed that a conventionally funded market participant would receive an allowed return equal to the full market cost of capital.

When valuing the network, management considers the value a knowledgeable willing party would place on the network in an arm's length transaction. We have applied the market cost of capital determined by the ORR in calculating the value of the network to a conventionally funded third party.

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

Discount rate

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

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 group's 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 utility companies 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.

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

	Change in cost of capital (basis points)	31 March 2014	31 March 2013
Change in fair value	25	£623m	£98m
	50	£1,245m	£195m
Percentage change in fair value	25	1.3%	0.2%
	50	2.5%	0.5%
Change in annual depreciation charge	25	£21m	£3m
	50	£42m	£7m

These sensitivities are calculated by reference to the RAB used to determine a return, equal to the regulatory determination of the cost of capital, as set out in the ORR's *Periodic Review 2013: Determination of Network Rail's outputs and funding 2014-19*. Twenty-five and fifty basis points were chosen as management's assessment of reasonably possible changes in the market cost of capital.

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

Forecast performance variations

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

Critical judgements

The valuation also includes the following critical judgements:

- Cash flows remain stable and robust. In determining a fair value, management must consider what a knowledgeable, willing party would value the network at in an arm's length transaction. The regulatory financial framework has remained robust and stable over recent years, although for the next control period the ORR has determined that it will not provide Network Rail with a return on equity as Network Rail is primarily debt funded. 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.
- The residual value of the railway network is considered immaterial to assessing its annual depreciation charge. This is because evidence from other disused parts of the railway network indicates that the residual value is negligible and includes significant onerous obligations. In addition, the value of the land on which the railway network stands is immaterial to the value of the assets that comprise the network.
- The valuation includes an assessment of the likely ORR determination in respect of regulatory outputs missed in CP4, and potential underperformance in the future.

The ORR is expected to conclude that the RAB should be reduced to reflect missed train performance targets, under delivery of renewals expenditure, uncertainty as to reported efficiency, under performance on network availability and a missed enhancement milestone during CP4. Network Rail has been in discussion with the ORR on the methodology and value of these adjustments, which will not be finalised until August 2014. Network Rail's estimate is that the RAB will be reduced by £189m. The principal uncertainty concerns whether the ORR will take into account the impact of external factors in the causes of missed train performance and how it will do so. This could improve their determination by £25m to £50m.

A further reduction of £1,339m has been made as a result of the inclusion of a tax adjustment in the ORR final determination for CP5. This was on the basis that the ORR considered the group had been over funded in previous years for corporation tax. As there is no opportunity to challenge this outcome further, it is appropriate to reflect the prospective RAB reduction in the valuation.

Network Rail has also considered expected performance during CP5. The group recently published its delivery plan, indicating that all regulatory targets are expected to be achieved with the exception of train performance in the first two years. This is largely a reflection of the CP4 exit position and Network Rail does not expect a RAB adjustment to be applied; however the ORR has not finalised its position on this. Going forward, in the event that it is considered unlikely to achieve regulatory targets, the potential value of that underperformance will be assessed and the valuation will be adjusted accordingly.

At the present time, Network Rail does not believe it will be able to meet the financial targets set by the ORR for CP5. Accordingly the valuation of the railway network has been reduced by £660m, which is analysed further below. The estimated potential cost of compensating operators is £200m, noting this cost could be between £90m and £600m. There is no financial allowance in the ORR determination for these potential costs. There are possible additional interest costs of £335m due to a combination of the assumptions in the determination and the impact of borrowing from Government. Lastly, we estimate that track renewals will cost £500m more than the ORR determination based on the likely unit cost of work, with the overspend being in the range of £200m to £1,000m. Network Rail only bears 25 per cent of the cost of the renewals overspend, therefore the valuation of the railway network has been reduced by £125m. The £660m adjustment assumes that £300m of savings will be achieved on operating and maintenance costs for which definite plans have yet to be put in place, and that approximately £500m of expenditure on property and on information technology will be funded through the spend to save mechanism in the ORR determination.

Notes to the financial statements continued

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

Depreciated replacement cost

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

The inflation-adjusted depreciated replacement cost of the network (after excluding the replacement cost of embankments, cuttings and tunnels) is estimated at £87.5bn (2013: £85.3bn).

As at 31 March 2014 the comparable valuation of the railway network according to the historical cost convention is £47,468m (2013: £42,149m).

As at 31 March 2014 and 31 March 2013 it has not been possible to identify the undepreciated capitalised interest or the undepreciated finance leases within the net book value of non-current assets. The depreciated interest capitalised since the date of adoption of the network value at deemed cost on 1 April 2002 was £889m (2013: £745m). No finance leased assets have been acquired since 1 April 2002.

The depreciation charge for the year is calculated using the average carrying value for the year and the estimated weighted average remaining useful economic life of the railway network. The weighted average remaining useful economic life of the railway network was calculated using the engineering assessment of serviceable economic lives of the major categories of asset that comprise the railway network. The estimated weighted average remaining useful economic life of the network is currently 30 years (2013: 30 years).

At 31 March 2014, the group had entered into contractual commitments in respect of capital expenditure amounting to £5,693m (2013: £1,356m).

13. Investment property

	Group £m
Fair value	
At 1 April 2012	878
Additions	7
Disposals	(3)
Transfer to property, plant and equipment	(92)
Decrease in fair value in the year	(39)
At 31 March 2013	751
Additions	15
Disposals	(4)
Transfer from property, plant and equipment	35
Increase in fair value in the year	59
At 31 March 2014	856

The fair values of the group's investment properties at 31 March 2014 have been arrived at on the basis of a valuation carried out at that date by Jones Lang LaSalle, external valuers not connected with the group.

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

The property rental income earned by the group from its investment property, all of which is leased out under operating leases, amounted to £99m (2013: £96m). Direct operating expenses arising on the investment properties in the year amounted to £6m (2013: £5m).

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

14. Investments in subsidiaries and joint ventures

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

<i>Principal subsidiaries</i>	Country of incorporation	Proportion of all classes of issued share capital owned	Principal activities
Network Rail Insurance Limited	Guernsey	100 %	Insurance
Network Rail Holdco Limited*	Great Britain	100 %	Holding company of Network Rail Infrastructure Limited
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 and CARE defined benefit pension schemes
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

Shares held by a trustee

Network Rail Infrastructure Finance PLC	Great Britain	Shares held by HSBC Trustee (C.I.) Limited	Issuer of the Debt Issuance Programme
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* Directly owned by Network Rail Limited company.

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

<i>Joint ventures</i>	Country of incorporation	Proportion of all classes of issued share capital owned	Principal activities
Solum Regeneration (GP) Limited	Great Britain	50 %	Holds 0.1 % of the property joint venture Solum Regeneration Limited Partnership
Solum Regeneration Epsom (GP) Limited	Great Britain	50 %	Holds 0.1 % of the property joint venture Solum Regeneration (Epsom) Limited Partnership
Solum Regeneration Limited Partnership	Great Britain	50 %	Property development
Solum Regeneration (Epsom) Limited Partnership	Great Britain	50 %	Property development
Solum Regeneration Christchurch LLP*	Great Britain	50 %	Property development
The Station Office Network LLP	Great Britain	50 %	Provides flexible office space, meeting rooms and virtual offices
West Hampstead Limited Partnership*	Great Britain	50 %	Property development

* New joint ventures entered into during the year.

Notes to the financial statements continued

15. Inventories

	2014 Group £m	2013 Group £m
Raw materials and consumables	173	157

As at 31 March 2014 a provision of £33m was held in respect of inventories (2013: £27m).

16. Finance lease receivables

	Minimum lease payments		Present value of minimum lease payments	
	2014 Group £m	2013 Group £m	2014 Group £m	2013 Group £m
Amounts receivable under finance leases:				
Within one year	2	2	2	2
In the second to fifth years inclusive	2	4	1	3
After five years	–	–	–	–
	4	6	3	5
Less: unearned finance income	(1)	(1)	n/a	n/a
Present value of minimum lease payments receivable	3	5	3	5
Analysed as:				
Current finance lease receivables (recoverable within one year)	2	2	2	2
Non-current finance lease receivables (recoverable after one year)	1	3	1	3
	3	5	3	5

The group has entered into a finance lease arrangement with a third party for telecommunications equipment. The lease is due to expire in 2017.

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

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

The fair value of the group's finance lease receivables at 31 March 2014 is estimated at £4m (2013: £6m) using a 1.78 per cent (2013: 0.97 per cent) discount rate based on the average cost of capital associated with the remaining life of the lease.

17. Trade and other receivables

	2014 Group £m	2013 Group £m	2014 Company £m	2013 Company £m
Non-current assets: other receivables				
Regulatory income receivable	135	–	–	–
	2014 Group £m	2013 Group £m	2014 Company £m	2013 Company £m
Current assets: trade and other receivables				
Trade receivables	294	240	–	–
Capital grants receivable	86	153	–	–
Other taxation and social security	149	102	–	–
Other receivables	164	58	–	–
Prepayments and accrued income	222	223	–	–
	915	776	–	–

Trade receivables include an allowance for estimated irrecoverable amounts from the supply of services of £16m (2013: £20m). This allowance has been made by reference to past default experience. Average debtor days were 36 days (2013: 36 days).

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

The group's credit risk is primarily attributable to its trade receivables. Around 95 per cent of the group's income is received from train operating companies 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 group 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 group uses an external credit scoring system to assess the potential customer's credit quality.

Included in the group's trade receivable balance are debtors with a carrying value of £25m (2013: £34m) which are past due at the reporting date for which the group has not provided as there has not been a significant change in the credit quality and the amounts are still considered recoverable. The group does not hold collateral over these balances. The average age of these receivables is 34 days (2013: 35 days).

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

	2014 Group £m	2013 Group £m	2014 Company £m	2013 Company £m
Past due by 1 – 28 days	19	23	–	–
Past due by 29 – 56 days	2	2	–	–
Past due by 57 – 84 days	1	2	–	–
Past due by 85 – 180 days	3	7	–	–
	25	34	–	–

Trade receivables of £15m (2013: £13m) are overdue by six months or more, and have been fully provided for.

Notes to the financial statements continued

18. Trade and other payables

	2014 Group £m	2013 Group £m	2014 Company £m	2013 Company £m
Current liabilities: trade and other payables				
Trade payables	601	488	–	–
Collateral received from banking counterparties	261	404	–	–
Payments received on account	19	–	–	–
Other payables	353	303	–	–
Other interest accruals	210	241	–	–
Other accruals and deferred income	2,442	1,958	–	–
	3,886	3,394	–	–

The average credit period taken for trade purchases is 25 days (2013: 30 days).

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

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

	2014 Group £m	2013 Group £m	2014 Company £m	2013 Company £m
Non-current liabilities: other payables				
Capital grants deferred income	2,668	2,524	–	–
Other payables	629	429	–	–
	3,297	2,953	–	–

19. Borrowings

	2014 Group £m	2013 Group £m	2014 Company £m	2013 Company £m
Net borrowings by instrument:				
Cash and cash equivalents*	1,253	3,506	–	–
Collateral placed with counterparties	36	14	–	–
Collateral received from counterparties	(261)	(404)	–	–
Commercial paper	(255)	(30)	–	–
Overdrafts	(51)	–	–	–
Bank loans	(469)	(666)	–	–
Bonds issued under the Debt Issuance Programme (less unamortised premium, discount and fees)	(33,240)	(32,778)	–	–
	(32,987)	(30,358)	–	–
Movement in net borrowings:				
At the beginning of the year	(30,358)	(27,282)	–	–
(Decrease)/increase in cash and cash equivalents	(2,253)	1,620	–	–
Increase in overdrafts	(51)	–	–	–
Proceeds from borrowings	(5,104)	(4,751)	–	–
Repayments of borrowings	3,975	1,203	–	–
Repayment of obligation under finance leases	–	1	–	–
Capital accretion	(298)	(485)	–	–
Exchange differences	304	(73)	–	–
Movement in collateral placed with counterparties	22	14	–	–
Movement in collateral received from counterparties	143	(323)	–	–
Fair value and other movements	633	(282)	–	–
At the end of the year	(32,987)	(30,358)	–	–
Net borrowings are reconciled to the balance sheet as set out below:				
Cash and cash equivalents*	1,253	3,506	–	–
Collateral placed with counterparties (included in trade and other receivables)	36	14	–	–
Collateral received from counterparties (included in trade and other payables)	(261)	(404)	–	–
Borrowings included in current liabilities	(2,707)	(4,120)	–	–
Borrowings included in non-current liabilities	(31,308)	(29,354)	–	–
	(32,987)	(30,358)	–	–

* Includes collateral received from derivative counterparties of £261m (2013: £404m).

Notes to the financial statements continued

19. Borrowings continued

	2014 Group £m	2013 Group £m	2014 Company £m	2013 Company £m
1.085% sterling index linked bond due 2052	123	119	–	–
0% sterling index linked bond due 2052	121	105	–	–
1.003% sterling index linked bond due 2051	23	22	–	–
0.53% sterling index linked bond due 2051	118	115	–	–
0.517% sterling index linked bond due 2051	119	115	–	–
0% sterling index linked bond due 2051	122	125	–	–
0.678% sterling index linked bond due 2048	116	114	–	–
1.125% sterling index linked bond due 2047	5,144	4,466	–	–
0% sterling index linked bond due 2047	73	75	–	–
1.1335% sterling index linked bond due 2045	47	47	–	–
1.5646% sterling index linked bond due 2044	264	259	–	–
1.1565% sterling index linked bond due 2043	53	52	–	–
1.1795% sterling index linked bond due 2041	65	64	–	–
1.2219% sterling index linked bond due 2040	261	256	–	–
1.2025% sterling index linked bond due 2039	71	70	–	–
4.6535% sterling bond due 2038	100	100	–	–
1.375% sterling index linked bond due 2037	5,011	4,932	–	–
4.75% sterling bond due 2035	1,227	1,226	–	–
1.6492% sterling index linked bond due 2035	396	389	–	–
4.375% sterling bond due 2030	870	870	–	–
1.75% sterling index linked bond due 2027	4,988	4,782	–	–
4.615% Norwegian krone bond due 2026*	56	62	–	–
4.57% Norwegian krone bond due 2026*	16	17	–	–
1.9618% sterling index linked bond due 2025	334	328	–	–
4.75% sterling bond due 2024	733	731	–	–
3% sterling bond due 2023	397	–	–	–
2.76% Swiss franc bond due 2021	203	208	–	–
2.315% Japanese yen bond due 2021*	64	79	–	–
2.28% Japanese yen bond due 2021*	64	79	–	–
2.15% Japanese yen bond due 2021*	63	79	–	–
4.625% sterling bond due 2020	998	997	–	–
1.75% US dollar bond due 2019**	599	–	–	–
0.875% US dollar bond due 2018**	1,023	–	–	–
Floating rate US dollar bond due 2017**	300	–	–	–
0.75% US dollar bond due 2017**	737	822	–	–
1% sterling bond due 2017	746	745	–	–
6% Australian dollar bond due 2016	278	344	–	–
4.4% Canadian dollar bond due 2016	271	324	–	–
0.625% US dollar bond due 2016**	775	–	–	–
1.25% US dollar bond due 2016**	607	673	–	–
1.125% sterling bond due 2016*	499	–	–	–
Floating rate sterling bond due 2016	599	599	–	–
0.625% US dollar bond due 2015**	900	994	–	–
4.875% sterling bond due 2015	1,266	996	–	–
1.25% sterling bond due 2015	1,499	1,498	–	–
0.875% US dollar bond due 2015**	901	997	–	–
2.5% sterling bond due 2014	–	1,257	–	–
1.5% US dollar bond due 2014**	–	1,164	–	–
Floating rate US dollar bond 2013**	–	658	–	–
3.5% US dollar bond due 2013	–	824	–	–
	33,240	32,778	–	–

* Bonds treated as fair value through profit and loss.

** Bonds in a fair value hedge arrangement.

All other bonds are shown net of unamortised discount and fees.

19. Borrowings continued

Bank loans are analysed as follows:

	2014 Group £m	2013 Group £m	2014 Company £m	2013 Company £m
Index-linked European Investment Bank due 2036 (£222m) and 2037 (£221m)	443	436	—	—
Barclays Bank due 2017 repayable by instalments	26	30	—	—
5.57 % European Investment Bank	—	200	—	—
	469	666	—	—

At 31 March 2014 and 2013 the group had the following undrawn committed borrowing facilities:

	2014 Drawn £m	2014 Undrawn £m	2014 Total £m	2013 Drawn £m	2013 Undrawn £m	2013 Total £m
Standby facility A	—	4,000	4,000	—	4,000	4,000
	—	4,000	4,000	—	4,000	4,000

Undrawn committed facilities expire as follows:

	2014 Group £m	2013 Group £m
Within one year	—	—
Within two to five years	—	—
After five years	4,000	4,000
	4,000	4,000

In addition the Secretary of State for Transport has provided unlimited financial indemnity in respect of borrowings under the Debt Issuance Programme.

Notes to the financial statements continued

20. Derivative financial instruments

	2014 Group	
	Fair value £m	Notional amounts £m
Derivative financial instrument assets		
Cash flow hedges		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	246	581
Forward starting interest rate swaps	308	11,519
Fair value hedges		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	3	606
Non-hedge accounted derivatives		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	79	198
Interest rate swaps	12	4,000
Forward foreign exchange contracts	–	65
	648	16,969
Included in non-current assets	637	13,405
Included in current assets	11	3,564
	648	16,969
Derivative financial instrument liabilities		
Cash flow hedges		
Interest rate swaps	(68)	583
Forward starting interest rate swaps	(59)	5,835
Fair value hedges		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	(322)	5,534
Non-hedge accounted derivatives		
Interest rate swaps to hedge debt issued under the Debt Issuance Programme	(212)	6,400
Forward foreign exchange contracts	(3)	229
	(664)	18,581
Included in current liabilities	(277)	7,353
Included in non-current liabilities	(387)	11,228
	(664)	18,581

20. Derivative financial instruments continued

	2013 Group	
	Fair value £m	Notional amounts £m
Derivative financial instrument assets		
Cash flow hedges		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	579	1,222
Fair value hedges		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	217	5,066
Non-hedge accounted derivatives		
Cross-currency swaps to hedge debt issued under the Debt Issuance Programme	133	198
Interest rate swaps	24	2,700
Forward foreign exchange contracts	–	17
	953	9,203
Included in non-current assets	697	6,807
Included in current assets	256	2,396
	953	9,203
Derivative financial instrument liabilities		
Cash flow hedges		
Interest rate swaps	(106)	583
Forward starting interest rate swaps	(86)	4,900
Non-hedge accounted derivatives		
Interest rate swaps to hedge debt issued under the Debt Issuance Programme	(438)	5,950
Forward foreign exchange contracts	(1)	48
	(631)	11,481
Included in current liabilities	(23)	542
Included in non-current liabilities	(608)	10,939
	(631)	11,481

Notes to the financial statements continued

21. Provisions

	Legal £m	Restructuring £m	Other £m	Total £m
At 1 April 2013	8	–	–	8
Charge for the year	3	4	135	142
Release for the year	(7)	–	–	(7)
At 31 March 2014	4	4	135	143
Included in current liabilities	4	4	135	143

Included in other provisions is the maximum possible financial penalty of £77m in respect of the missed 2014 long distance punctuality target and lease provisions of £36m.

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

Contingent liability

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

The group's lawyers have advised that the provisions for the claims are realistic and no 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 group.

22. Deferred tax

The following are the deferred tax liabilities and assets recognised by the group and movement thereon during the current and prior year.

Group	Accelerated tax depreciation £m	Revaluation of railway network £m	Short-term timing differences including retirement benefit obligations £m	Derivatives £m	Tax losses £m	Total £m
At 1 April 2012	3,246	1,357	(202)	(213)	(1,110)	3,078
(Credit)/charge to income	(73)	1	(23)	(5)	163	63
(Credit)/charge to other comprehensive income	–	(140)	(128)	36	–	(232)
At 1 April 2013	3,173	1,218	(353)	(182)	(947)	2,909
(Credit)/charge to income	(696)	–	2	122	350	(222)
(Credit)/charge to other comprehensive income	–	(370)	50	124	–	(196)
At 31 March 2014	2,477	848	(301)	64	(597)	2,491

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

	2014 £m	2013 £m
Deferred tax liabilities	3,389	4,391
Deferred tax assets	(898)	(1,482)
	2,491	2,909

23. Notes to the statement of cash flows

	2014 Group £m	2013 Group restated* £m	2014 Company £m	2013 Company £m
Profit before tax	1,035	747	–	–
Adjustments for:				
Property revaluation movements and profits on disposal	(96)	3	–	–
Fair value (gain)/loss on derivatives and debt	(304)	43	–	–
Net interest expense	1,366	1,414	–	–
Depreciation of the railway network	1,603	1,491	–	–
Amortisation of capital grants	(82)	(81)	–	–
Amortisation of intangible assets	1	1	–	–
Movement in retirement benefit obligations	56	24	–	–
Increase/(decrease) in provisions	135	(4)	–	–
Operating cash flows before movements in working capital	3,714	3,638	–	–
Increase in inventories	(16)	(32)	–	–
Increase in receivables	(311)	(106)	–	–
Increase in payables	384	249	–	–
Cash generated from operations	3,771	3,749	–	–

* The comparatives have been restated for adoption of IAS 19 (Revised) 'Employee Benefits'

Cash and cash equivalents

Cash and cash equivalents (which are represented as a single class of assets on the face of the balance sheet) comprise cash at bank, collateral, commercial paper and money market deposit investments, all of which are on call with the exception of £163m of short-term deposits with an average term of 22 days (2013: £282m 29 days) from the balance sheet date. Cash and money market deposits had an average maturity of ten days (2013: five days) from the balance sheet date.

Notes to the financial statements continued

24. Operating lease arrangements

	2014 Group £m	2013 Group £m
<i>The group as lessee</i>		
Minimum lease payments under operating leases recognised in the income statement in the year	28	24

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

	2014 Group £m	2013 Group £m
Within one year	33	19
In the second to fifth years inclusive	115	73
After five years	30	85
	178	177

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

The group as lessor

Operating lease rentals earned in the year by the group were £263m (2013: £260m). This amount includes property rental income of £238m (2013: £233m), as disclosed in Note 3.

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

	2014 Group £m	2013 Group £m
Within one year	334	368
In the second to fifth years inclusive	594	624
After five years	1,291	1,120
	2,219	2,112

25. Funding and financial risk management

Introduction

The group is almost entirely debt funded. Debt has been issued through the special purpose financing company Network Rail Infrastructure Finance PLC, which is not a member of the Network Rail Limited group, but is treated as a subsidiary for accounting purposes. The majority of the group's existing debt has been issued by Network Rail Infrastructure Finance PLC under the Debt Issuance Programme which is rated AAA by Standard & Poor's, Aa1 (stable outlook) by Moody's and AA+ (stable outlook) by Fitch. The Debt Issuance Programme is supported by a financial indemnity from the Secretary of State for Transport which expires in 2052.

Debt has been issued in a number of currencies and a range of maturities which gives rise to interest rate, foreign currency and inflation risk. Financial risk management aims to mitigate these risks.

Reclassification of Network Rail

In December 2013, the Office for National Statistics announced its intention to reclassify 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).

On 23 April 2014, the UK Debt Management Office included the following in their press release '2013-14 CGNCR Outturn: Revision to the DMO Financing Remit 2014-15':

"It was announced in December 2013 that the UK Government, the Office of the Rail Regulator and Network Rail would explore whether alternative approaches or refinements to Network Rail's current borrowing model could deliver a more efficient approach, and if so from what point in time these might be introduced. The UK Government has now determined that, in future, value for money for the taxpayer will best be secured by Network Rail borrowing directly from the UK Government, rather than by Network Rail issuing debt in its own name. The Department for Transport and Network Rail are discussing details of a possible loan arrangement in advance of Network Rail's formal reclassification to the public sector in September 2014. The UK Government's current expectation is that it may lend up to £6.5 billion to Network Rail during the 2014-15 financial year. It is therefore factoring this into its financing plans."

Network Rail Infrastructure Finance PLC currently advances all net proceeds from financing activities to Network Rail Infrastructure Limited via an intercompany loan. The possible loan arrangement referred to in the Debt Management Office announcement would result in loans being made by the Department for Transport direct to Network Rail Infrastructure Limited to fund the continuing programme of long-term investment in the national rail network. In these circumstances, Network Rail Infrastructure Finance PLC would not anticipate issuing further bonds 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 Debt Issuance Programme, including nominal and index-linked benchmarks and private placements in all currencies, will continue to benefit from the direct and explicit guarantee from the UK Government under the Financial Indemnity Mechanism.

Externally imposed capital requirements

The Network Rail group 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 debt 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).

Notes to the financial statements continued

25. Funding and financial risk management continued

The RAB and regulatory debt are reconciled to property, plant and equipment (in Note 12) and net debt (in Note 19) as follows:

	2014 £m	2013 £m
Net debt per Note 19	(32,987)	(30,358)
Revaluations and remeasurements	687	1,428
Regulatory net debt	(32,300)	(28,930)

The RAB used to calculate the debt to RAB ratio is:

	2014 £m	2013 £m
Railway network per Note 12	49,833	46,411
Investment properties per Note 13	856	751
Capital grant funded assets	(2,688)	(2,500)
Other fair value adjustments	1,946	276
RAB	49,947	44,938

The debt to RAB ratio at 31 March 2014 and 2013 was as follows:

	2014	2013
Debt: RAB ratio	64.7%	64.4%

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

The group's subsidiary, Network Rail Infrastructure Limited, owns and operates Britain's rail network under licence from the ORR. 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.

Significant accounting policies

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

25. Funding and financial risk management continued

Summary table of financial assets and liabilities

The following table presents the carrying amounts and the fair values of the group's financial assets and liabilities at 31 March 2014 and 31 March 2013.

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

- Bank loans – based on market data at the balance sheet date and the net present value of discounted cash flows
- Certain bonds issued under the Debt Issuance Programme – based on market data at the balance sheet date. Where market data is not available valuations have been obtained from dealing banks.

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

Group	2014		2013	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets				
Cash and cash equivalents as loans and receivables	1,253	1,253	3,506	3,506
Other non-derivative financial assets				
Finance lease receivables	3	4	5	6
Trade and other receivables (less prepayments and accrued income and other taxation and social security)	679	679	451	451
Derivatives				
Derivatives designated as cash flow hedging instruments	554	554	579	579
Derivatives designated as fair value hedging instruments	3	3	217	217
Other derivatives as fair value through profit and loss	91	91	157	157
Total derivatives	648	648	953	953
Total financial assets	2,583	2,584	4,915	4,916
Financial liabilities				
Financial liabilities held at amortised cost				
Overdraft	(51)	(51)	–	–
Commercial paper	(255)	(255)	(30)	(30)
Bank loans	(469)	(617)	(666)	(868)
Bonds issued under the Debt Issuance Programme	(32,479)	(33,375)	(32,462)	(35,268)
Financial liabilities designated as fair value through profit and loss				
Bonds issued under the Debt Issuance Programme	(761)	(761)	(316)	(316)
Total borrowing	(34,015)	(35,059)	(33,474)	(36,482)
Trade and other payables at amortised cost	(4,262)	(4,262)	(3,436)	(3,436)
Derivatives				
Derivatives designated as cash flow hedging instruments	(127)	(127)	(192)	(192)
Derivatives designated as fair value hedging instruments	(322)	(322)	–	–
Other derivatives as fair value through profit and loss	(215)	(215)	(439)	(439)
Total derivatives	(664)	(664)	(631)	(631)
Total financial liabilities	(38,941)	(39,985)	(37,541)	(40,549)

Notes to the financial statements continued

25. Funding and financial risk management continued

Derivatives

The group (including the group's special purpose financing company, Network Rail Infrastructure Finance PLC) uses derivative financial instruments to reduce exposure to foreign exchange risk and interest rate movements. The group does not use derivative financial instruments for speculative purposes. Certain derivatives are designated as hedges, and those derivatives that are not hedge accounted are fair valued immediately through the income statement. The group has a comprehensive risk management process.

The board, through a treasury sub-committee (the treasury committee), has approved and monitors the risk management processes, including documented treasury policies, counterparty limits, controlling and reporting structures.

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

Credit risk

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

For debt designated as fair value through profit and loss (FVTPL) there has been no change in carrying value as a result of changes in the group's credit risk. The gains in the income statement arising from the remeasurement of FVTPL debt items of £54m (2013: £3m gain) are all attributable to changes in market risk.

The credit risk with regard to all classes of derivative financial instruments entered into before 1 January 2013 is limited because Network Rail has arrangements in place which limit each bank to a threshold (based on credit ratings), which if breached requires the bank to post collateral in cash or eligible securities. The members of the banking group are required to post collateral on positive mark to market swaps above the threshold. In December 2012 the group entered into new collateral agreements in respect of derivative trades entered into after 1 January 2013. Under the terms of the new agreements Network Rail posts collateral on adverse net derivative positions with its counterparties. The new agreements do not contain a provision for thresholds; as such Network Rail or its counterparties are required to post collateral for the full fair value of net out of the money positions. At 31 March 2014 the fair value of collateral held was £261m (2013: £404m). The group is the beneficial owner of this collateral. The group is free to invest or otherwise utilise the collateral at its discretion, subject to acting within the authority sanctioned by the treasury committee. The balance of collateral posted by the group at 31 March 2014 was £36m (2013: £14m).

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

The group considers its maximum exposure to credit risk to be the sum of its financial assets as set out on page 135.

Foreign exchange risk

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

It is estimated that a general increase of 10 percentage points in the value of any currency against sterling would have no material effect on the group's profit before tax or equity due to all currency positions being 100 per cent hedged and therefore no sensitivity analysis is produced.

25. Funding and financial risk management continued

Interest rate and inflation risk

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

Debt with a carrying value of £29,277m (2013: £30,424m) is arranged at or swapped into fixed interest rates and exposes the group to fair value interest rate risk. Other borrowings were arranged at or swapped into floating rates, thus exposing the group to cash flow interest rate risk.

The group has forward starting interest rate swaps with a notional value of £17,354m which hedge the interest rate on forecast borrowings in CP5. The weighted average rate on these swaps is 2.73 per cent.

The group has certain debt issuances which are index-linked and so are exposed to movements in inflation rates. The group does not enter into any derivative arrangements to hedge its exposure to inflation in relation to its index-linked debt, but rather to mitigate the effects of inflation on the group's retail price index-linked revenue streams.

Sensitivity analysis

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

	Group 31 March 2014		Group 31 March 2013	
	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	(101)	447	147	50
1 % increase in the GBP RPI on index linked bonds	(172)	–	(157)	–

A one per cent decrease in the above rates 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.

The group believes that the above analysis is unrepresentative of the risks inherent in issuing index-linked debt. Franchised track access and grant income constitute £6,020m (2013: £5,893m) of revenue which is far in excess of an index-linked interest expense of £232m (2013: £217m). Currently, these sources of income are contractually index-linked and, whilst there is no absolute contractual guarantee for future regulatory control periods that this will continue, the group is highly confident that this will continue to be the case. Therefore, the natural hedge that exists between finance costs and revenue mitigates the risk of RPI movements.

During the year the group issued £500m of index-linked bonds, maintaining the proportion of index-linked debt to nominal debt within the ratio set by the treasury committee.

Notes to the financial statements continued

25. Funding and financial risk management continued

Liquidity risk management

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

The group manages liquidity risk by maintaining sufficient cash and facilities to cover at least one year's working capital requirement by continuously monitoring forecast and actual cash flows. Included in Note 19 is a description of additional undrawn facilities that the group has at its disposal to further reduce liquidity risk.

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

<i>Group</i>	Within 1 year £m	1-2 years £m	2-5 years £m	5+ years £m	Total £m
31 March 2014					
Non-derivative financial liabilities					
Bank loans and overdrafts	(315)	(9)	(34)	(981)	(1,339)
Bonds issued under the Debt Issuance Programme					
– Sterling denominated bonds	(1,794)	(2,128)	(1,859)	(6,265)	(12,046)
– Sterling denominated index-linked bonds	(234)	(241)	(768)	(40,688)	(41,931)
– Foreign currency denominated bonds	(992)	(1,254)	(4,456)	(494)	(7,196)
Trade and other payables	(3,423)	(519)	–	–	(3,942)
Derivative financial liabilities					
Net settled derivative contracts	(216)	(65)	(186)	253	(214)
Gross settled derivative contracts – receipts	992	1,254	4,422	–	6,668
Gross settled derivative contracts – payments	(1,042)	(1,293)	(4,368)	–	(6,703)
	(7,024)	(4,255)	(7,249)	(48,175)	(66,703)
Group					
31 March 2013					
Non-derivative financial liabilities					
Bank loans and overdrafts	(239)	(9)	(37)	(533)	(818)
Bonds issued under the Debt Issuance Programme					
– Sterling denominated bonds	(1,543)	(1,765)	(2,982)	(5,989)	(12,279)
– Sterling denominated index-linked bonds	(213)	(221)	(707)	(40,999)	(42,140)
– Foreign currency denominated bonds	(2,758)	(1,065)	(3,266)	(562)	(7,651)
Trade and other payables	(2,875)	(320)	–	–	(3,195)
Derivative financial liabilities					
Net settled derivative contracts	(239)	(141)	(38)	138	(280)
Gross settled derivative contracts – receipts	2,758	1,065	3,249	–	7,072
Gross settled derivative contracts – payments	(2,451)	(1,046)	(2,704)	–	(6,201)
	(7,560)	(3,502)	(6,485)	(47,945)	(65,492)

25. Funding and financial risk management continued

Offsetting financial assets and liabilities

a) Financial assets

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

Group	Gross amounts of recognised financial assets £m	Gross amounts of recognised financial liabilities set off in the balance sheet £m	Net amount of financial assets presented in the balance sheet	Related amounts not set off in the balance sheet		Net amount
				Financial instruments	Cash collateral received	
31 March 2014						
Derivative financial assets	648	–	648	(345)	(168)	135

Group	Gross amounts of recognised financial assets £m	Gross amounts of recognised financial liabilities set off in the balance sheet £m	Net amount of financial assets presented in the balance sheet	Related amounts not set off in the balance sheet		Net amount
				Financial instruments	Cash collateral received	
31 March 2013						
Derivative financial assets	953	–	953	(224)	(391)	338

a) Financial liabilities

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

Group	Gross amounts of recognised financial liabilities £m	Gross amounts of recognised financial assets set off in the balance sheet £m	Net amount of financial liabilities presented in the balance sheet	Related amounts not set off in the balance sheet		Net amount
				Financial instruments	Cash collateral paid	
31 March 2014						
Derivative financial liabilities	(664)	–	(664)	345	(57)	(376)

Group	Gross amounts of recognised financial liabilities £m	Gross amounts of recognised financial assets set off in the balance sheet £m	Net amount of financial liabilities presented in the balance sheet	Related amounts not set off in the balance sheet		Net amount
				Financial instruments	Cash collateral paid	
31 March 2013						
Derivative financial liabilities	(631)	–	(631)	224	2	(405)

Cash flow hedges

Contractual payments on derivatives designated as cash flow hedges impact the income statement and will all have matured by 2027.

Borrowings

Details of the group's undrawn committed facilities and types of debt instrument used can be found in Note 19.

Notes to the financial statements continued

25. Funding and financial risk management continued

Fair value measurements recognised in the balance sheets

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

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

	2014			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Property, plant and equipment – the railway network	–	–	49,833	49,833
Investment properties	–	–	856	856
Derivative financial assets	–	648	–	648
Assets	–	648	50,689	51,337
Derivative financial liabilities	–	(664)	–	(664)
Financial liabilities designated at fair value	(762)	(5,842)	–	(6,604)
Liabilities	(762)	(6,506)	–	(7,268)
Total	(762)	(5,858)	50,689	44,069

	2013			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Property, plant and equipment – the railway network	–	–	46,411	46,411
Investment properties	–	–	751	751
Derivative financial assets	–	953	–	953
Assets	–	953	47,162	48,115
Derivative financial liabilities	–	(631)	–	(631)
Financial liabilities designated at fair value	(316)	(5,306)	–	(5,622)
Liabilities	(316)	(5,937)	–	(6,253)
Total	(316)	(4,984)	47,162	41,862

There were no transfers between Level 1 and 2 during either financial year.

The fair value of 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 group 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 group'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 group. Further details on this valuation technique are disclosed in note 13.

26. Retirement benefit schemes

Defined contribution schemes

On 1 April 2004 the group introduced a defined contribution pension scheme, the Network Rail Defined Contribution Pension Scheme (NRDCPS). This scheme is 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 2014, the NRDCPS had 8,510 members (2013: 6,668) and the average employer contribution rate in the year was 6.5 per cent (2013: 5.6 per cent).

Defined benefit schemes

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

The assets transferred to the RPS from the BRPS on 1 October 1994 were apportioned 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 group announced its decision to cap its contribution to British Railways Additional Superannuation Scheme (BRASS) matching at current levels for existing employees and to dispense with matching for new employees. The 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 2014 and 31 March 2013.

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

The group pays contributions of 14.04 per cent of Section Pay for Pre-July 2012 members and 10.5 per cent of RPS 2012 Section Pay for RPS 2012 members. The members pay contributions of 9.36 per cent of Section Pay for Pre-July 2012 members and 7.0 per cent of RPS 2012 Section Pay for RPS 2012 members. These rates are expected to continue until 30 June 2018 when the employer contribution rates will revert to 60 % of the long-term joint contribution rate of 21.8 % of Section Pay for Pre-July 2012 Members and 16.1 % of RPS 2012 Section Pay for RPS 2012 Members. Future rates are subject to review following the completion of the actuarial valuation at 31 December 2013. The equivalent rates for the CARE scheme are 10.9 per cent for group contributions and 7.9 per cent for member contributions.

The estimated amounts of contributions expected to be paid by the group and members to the schemes during the year ended 31 March 2015 are £124m and £70m respectively. If a surplus or deficit arises, the provisions in the rules mean that the group and members benefit from or pay for this respectively in the proportion 60:40.

	2014 %	2013 %
<i>Key assumptions used:</i>		
Discount rate	4.4	4.4
Expected rate of price inflation and CARE benefit increases (RPI measure)	3.3	3.3
Future earnings increases*	4.3	4.3
Future pension increases – RPS (CPI measure)	2.3	2.5

* Inclusive of a promotional salary scale of 0.5 per cent per annum. From 31 March 2012 promotional salary increases are assumed to apply only in respect of service after the date of promotion.

Notes to the financial statements continued

26. Retirement benefit schemes continued

	2014		2013	
	Males	Females	Males	Females
Average life expectancy for mortality tables used to determine defined benefit obligations:				
– Member aged 65 now (pension under £9,300 pa or pensionable pay under £35,000 pa)	20.7	22.6	20.6	22.5
– Member aged 65 now (others)	22.9	25.0	22.8	24.9
– Member aged 65 in 20 years' time (pension under £9,300 pa or pensionable pay under £35,000 pa)	23.1	25.1	23.0	25.0
– Member aged 65 in 20 years' time (others)	25.1	27.4	25.0	27.3

For the Network Rail Section of the RPS the discounted mean term of the Defined Benefit obligation is 18 years, for the CARE scheme it is 33 years.

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

	2014 £m	2013 restated £m
Current service cost – defined contribution (see Note 6)	13	12
Current service cost – defined benefit (see Note 6)	162	129
Interest cost	54	32
	229	173

The current service cost has been included in employee costs, the net interest scheme deficit has been included in finance costs.

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

	2014 £m	2013 restated £m
(Gain)/loss on defined benefit obligation due to experience	(35)	36
(Gain)/loss on defined benefit obligation due to assumption changes	(99)	629
Return on plan assets greater than discount rate	(6)	(115)
Actuarial (gain)/loss on defined benefit pension scheme	(140)	550

The cumulative amount of actuarial losses recognised in other comprehensive income was £848m (2013: £988m restated).

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

	2014 £m	2013 £m
The defined benefit obligation is made up as follows:		
Active members	(4,004)	(3,949)
Deferred pensioner members	(581)	(542)
Retired members	(1,826)	(1,738)
Present value of defined benefit obligation	(6,411)	(6,229)
Fair value of scheme assets	4,350	4,117
Deficit in the scheme	(2,061)	(2,112)
Group's share (60%) of the scheme deficit recognised in the balance sheet	(1,237)	(1,267)

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

Cumulative gains or losses are recognised in equity.

26. Retirement benefit schemes continued

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

	Asset £m	Liabilities £m	Deficit £m
At 1 April 2012	3,683	(4,785)	(1,102)
Current service cost including members' share*	–	(216)	(216)
Interest on pension deficit*	192	(246)	(54)
Administration expenses	(7)	–	(7)
Return on plan assets greater than the discount rate	191	–	191
Actuarial loss arising from changes in financial assumption	–	(1,048)	(1,048)
Actuarial loss arising from experience adjustments	–	(60)	(60)
Regular contributions by employer	117	–	117
Contributions by employees	67	–	67
Benefits paid	(126)	126	–
At 1 April 2013	4,117	(6,229)	(2,112)
Current service cost including members' share	–	(271)	(271)
Interest on pension deficit	182	(272)	(90)
Administration expenses	(8)	–	(8)
Return on plan assets greater than the discount rate	11	–	11
Actuarial gain arising from changes in financial assumption	–	165	165
Actuarial gain arising from experience adjustments	–	59	59
Regular contributions by employer	119	–	119
Contributions by employees	66	–	66
Benefits paid	(137)	137	–
At 31 March 2014	4,350	(6,411)	(2,061)

* The comparatives have been restated for adoption of IAS 19 (Revised) 'Employee Benefits'

The actual return on scheme assets was £193m (2013: £383m).

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

	Fair value of assets		Percentage of assets	
	2014 £m	2013 £m	2014 %	2013 %
Equity instruments	3,884	3,579	89.29	86.93
Debt instruments – Government	277	250	6.37	6.08
Debt instruments – non-Government	178	162	4.09	3.93
Property	–	96	–	2.33
Other	11	30	0.25	0.73
	4,350	4,117		

The group 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 or 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 defined benefit obligation, 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.

Notes to the financial statements continued

26. Retirement benefit schemes continued

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.

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

	2014 £m	2013 £m
Discount rate		
Change in defined benefit obligation at year end from a 25 basis points increase	(277)	(266)
Change in defined benefit obligation at year end from a 25 basis points decrease	291	280
Mortality		
Change in defined benefit obligation from a one year increase in longevity	156	162
Change in defined benefit obligation from a one year decrease in longevity	(153)	(174)
Earnings increase		
Change in defined benefit obligation at year end from a 25 basis points increase	80	–
Change in defined benefit obligation at year end from a 25 basis points decrease	(79)	–
Price inflation (CPI measure)*		
Change in defined benefit obligation at year end from a 25 basis points increase	296	–
Change in defined benefit obligation at year end from a 25 basis points decrease	(283)	–

* Including consistent increases to RPI, salary growth and RPI/CPI related pensions assumptions.

In preparing the consolidated financial statements, comparative amounts have been restated for the adoption of IAS 19 (Revised).

The impact on comparative year figures is as follows:

Income statement:

Net operating costs	(10)
Finance costs	(18)
Tax	6
	(22)
Other comprehensive income	22

Company information

Calendar 2014/15

31 March 2014	Year end
12 June 2014	Preliminary results announced for full year to 31 March 2014
18 July 2014	Annual general meeting of Network Rail Limited
27 November 2014	Results for half-year announcement to 30 September 2014
31 March 2015	Year end