



Annual Report and Accounts

Network Rail Infrastructure Limited (formerly Railtrack PLC)

A subsidiary of Network Rail Limited

2003

Officers

Network Rail Infrastructure Limited

Directors

John Armitt
David Bailey
Jim Cornell
Iain Coucher
Peter Henderson
Ron Henderson
Charles Hoppe
Chris Leah
Ian McAllister
Adrian Montague
Ross Sayers
Sir Robert Smith

Other directors who served in the year to 31 March 2003

Sebastian Bull (resigned 3 October 2002)
Richard Middleton (resigned 3 October 2002)
John O'Brien (resigned 19 April 2002)

Secretary

Hazel Walker

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Financial Highlights

	2003	2002 (restated)*
	£m	£m
Turnover	2,965	2,912
Operating profit	80	521
Net interest payable, including exceptional interest charge of £106m (2002: £118m)	(415)	(318)
(Loss)/ profit before taxation	(290)	295
Net cash inflow from operating activities	192	498
Net debt	(9,404)	(6,299)
Railway network fixed assets	12,764	9,146
Net assets	1,748	983
Capital expenditure	3,121	2,854
Maintenance expenditure	1,184	951
Performance – million minutes delay	14.7	13.4

* The comparative financial information has been restated for changes in accounting policies in respect of railway network fixed assets and deferred taxation.

Chairman's Statement



The last year has seen a major change in Britain's railways with Network Rail taking over the ownership of the infrastructure from Railtrack Group PLC. The change of ownership took place on 3rd October 2002 when Network Rail Limited acquired Railtrack PLC and subsequently renamed it Network Rail Infrastructure Limited.

It is not possible to review the year without recalling the accident at Potters Bar on 10th May 2002. Whilst the root cause of the accident is still under investigation, no one at Network Rail underestimates the need to continue to strive to improve the safety of Britain's railways, and John Amitt covers details of the accident in the Chief Executive's Review.

Network Rail has a different structure from Railtrack. It is a company limited by guarantee. The organisation is a 'not for dividend' company with members rather than shareholders. The Company is run along commercial lines and any profit will be reinvested in the railway.

There are two categories of Members; Industry Members who are representatives of railway licence holders and Public Members, representatives of stakeholder groups and private individuals who are selected by an independent Membership Selection Panel. The role of our members is to hold the Board accountable for the stewardship of the Company and to act in support of the interests of Network Rail. In addition, the Board has adopted high standards of corporate governance, equivalent to those of a major PLC.

Under Network Rail the focus of our business is clear; operations, maintenance and renewals. Our vision is one of engineering excellence, which will enable us to deliver a more reliable network, with high levels of safety standards. The new executive team has settled in quickly and a series of major action plans has been put in place across all elements of the business to deliver the much needed step change to achieve our corporate goals.

The first requirement was to reorganise operations with the Regional Directors now reporting to the Deputy Chief Executive, Iain Coucher. This was implemented by 18 November 2002. In tandem, a common organisational structure is being introduced over all regions to ensure consistent activities focusing on improving performance. This has been a major change affecting approximately 8,000 people and is being implemented progressively with completion scheduled for mid-June 2003. In addition Area Delivery Groups within the regions will give better local control and accountability for work on the network. Responsibility for day-to-day delivery will now be placed squarely at area level under the control of General Managers.

The period since acquisition also saw the Company spending substantially more on maintenance and renewals than had been allowed for in the Rail Regulator's periodic review. The additional spending reflects a catching up of a backlog of much needed investment in the railway.

An important move was to take greater control over maintenance policies and the use of contractors. We have announced the introduction of a New Maintenance Programme whereby Network Rail will take back from the contractors the responsibility for deciding what has to be done, when it has to be done and ensuring it has been done. We have also decided to bring maintenance in-house in three contract areas which cover high-speed non-electrified track, third rail electrification and high-speed overhead line electrification. These were selected to give us a better understanding of the issues involved in maintenance, the costs involved and subsequently to enable us to become a better informed buyer of the services of maintenance contractors.

A key priority is to engage our employees who have to deliver our future plans. In late 2002 a series of road shows was held around the country where top management presented our vision to over 6,000 employees. The feedback from the road shows has been enormously helpful in understanding the magnitude of change ahead and learning from some of the mistakes from the past.

The period also saw the ordering of special trains to automate the inspection process, the ordering of high output grinders and ballast cleaners and the introduction of Integrated Planning Units to improve possession management.

In parallel with these activities we were also forging closer working links with our industry partners. Much of the period was spent working very closely with the Strategic Rail Authority (SRA) to redefine the West Coast Route Modernisation Project. The aim was to take a major project, which had an undeliverable scope of works and burgeoning costs and turn it into a workable scheme at a deliverable cost. The publication of the West Coast Strategy and the decision to take multi-week possessions, whilst utilising diversionary routes, to speed up work all arose from these discussions.

The Office of the Rail Regulator, SRA and the train and freight operators were also very supportive of our new aims and objectives. The introduction of Joint Boards at which the Company, train and freight operators and our maintenance contractors address the challenges facing the network is an example of closer working to deliver a better performance to the travelling public.

Our Business Plan, launched on 31st March 2003 sets out the initiatives we are taking in all areas of our operations and covers our strategic direction for the next ten years with detailed plans for the next three years. The plan provides the basis for our discussion with the Rail Regulator on the Interim Review.

However, we must also be realistic about the challenges we face. Substantial growth on the network, allied to a history of under-investment, has left us with a fragile network which is expensive to put right. Improving performance and reducing total cost must be our focus, but we must also work with our contractors to make up the significant backlog in renewals.

During the period the first steps were taken to address the difficulties of the past. It will take several years, but our goal is to build a rail infrastructure which will demonstrate sustainable improvement in performance at an acceptable cost to the nation.



Ian McAllister (Chairman)
4 June 2003

Chief Executive's Review



Running the railway infrastructure is a complex business and there has been no let up in the commitment of the people who ensure it works 24 hours a day, seven days a week, 365 days a year. The year has seen the business and its people continue to gain a better understanding of the realities we face and the many and varied changes which are needed in order to deliver real improvements at an efficient cost.

Uppermost in our minds is the tragic accident, which took place at Potters Bar on 10 May 2002 when a train was derailed and seven people died. It was soon apparent that the immediate cause was the failure of a set of points on the approach to the station. Checks across the rest of the network revealed no other points in comparable condition. The root cause of the incident remains the subject of a Health and Safety Executive (HSE) investigation and British Transport Police enquiries.

In these circumstances, where none of the various investigations underway have been able to identify the root cause of the incident, the Company agreed, without prejudice to any issue of liability, to act on behalf of the industry parties in handling and settling claims from members of the public arising from the incident.

This incident once again brought home to everyone that a safe railway must continue to be our first priority.

In terms of performance it has been a mixed year with improvements in some areas overshadowed by deterioration in others, most notably train performance where a 9% increase in infrastructure attributable delays leaves us accountable for 55% of all train delays for the year to 31 March 2003. We must improve upon this performance and have outlined demanding but realistic targets and specific plans to achieve this.

We are currently meeting with our industry partners to find ways we can work together to make improvements. Over recent months there has been a new-found co-operation between all parties that is enabling progress to be driven through the industry.

Improved efficiency is another area in which the industry needs to work together. There is only a limited amount of money available to deliver a better railway and if targets and commitments are to be kept we will have to make our resources go further.

In the last six months we have been putting in place the foundations to enable us to deliver these efficiency savings. Over the next three years we anticipate that these organisational and engineering changes will deliver substantial savings that can be reinvested to improve the network.

The year we have just gone through is not one we would want to repeat in terms of incidents and uncertainty over ownership and any review of the year would not be complete without mention of the role of the administrators for the first six months of the year. Throughout Special Railway Administration we worked closely with Alan Bloom's team from Ernst & Young and I am grateful to them for their support during this time.

Organisation Change

Following the acquisition of Railtrack PLC we have focused on organisational and cultural change as these are the key drivers for the improvements in performance, cost and service to our customers.

In the last few months we have introduced an employee engagement programme called Q12, organised by Gallup. This measures staff engagement levels and the style and nature of management throughout the business. The results will enable us to identify the management culture and training needed to ensure the maximum engagement and contribution from all our staff.

The executive directors held 12 road shows around the country to brief over 6,000 of our employees on Network Rail's vision and objectives for the future. We have also held a series of team building workshops for our 200 senior managers, under the title - 'you make a difference'. The aim has been to engender ownership of Network Rail's vision, aims and values and to create genuine understanding of, support for, and commitment to what we are trying to achieve with this core management team.

We have put in place a number of key organisational changes. For the first time in its history the business has a standard structure for the organisation of the Regions. This will ensure consistency of approach for ourselves and those who interface with us. It facilitates the drive to put in place common processes and procedures which will allow greater control and better delivery of our core business; operations, maintenance and renewals to the infrastructure. Area Delivery Groups within the regions will give better local control and accountability for work on the network.

In order to improve the interface between the major renewal activity on the West Coast route and maintenance of the line, we have put responsibility for both activities under a revised West Coast management unit.

The railway land assets and operational concerns, which include the stations under Network Rail control and the commercial and operational property portfolio, have been combined into a single Railway Estates department. This will ensure the Company maximises the opportunities presented by our extensive property interests, particularly at the 16 key stations whilst ensuring that the operation of the railway is not compromised.

Looking forward there is still much to be done. We are reviewing the role of all our support services and their interface with the Regions. It is important that we remove any duplication or unnecessary activity in order to improve work systems and accountability as well as to reduce costs and maximise efficiency.

Safety

The year was over-shadowed by the tragic accident at Potters Bar mentioned earlier. However, other aspects of safety continued to improve.

Key facts relating to safety are:

- The number of broken rails has been reduced by 17% to 445
- Severe SPADS were reduced by 14% to 146

The above are both at their lowest levels since records began

- Significant train accidents and derailments fell by 20% to 41, also the lowest yearly number on record.
- Collisions at level crossings increased from 18 to 21

The year-end witnessed the creation of the Railway Safety Standards Board (RSSB) as recommended by Lord Cullen. All employees of Railway Safety, the company previously owned by Network Rail, transferred under TUPE arrangements to the new company, which is now outside the Network Rail Group. The Board of RSSB will undertake the development of railway standards, provide safety leadership in the industry and sponsor research. We look forward to working closely with the RSSB in developing a safer railway environment for all.

During the year a joint industry review led by the Strategic Rail Authority (SRA) of the European Rail Traffic Management System (ERTMS) was conducted. As a result the Secretary of State has accepted the recommendations of the Health & Safety Commission and continued sponsorship of a single national programme for ERTMS development, led by the SRA. Network Rail is providing technical support to the SRA.

The year saw excellent progress on the installation of the TPWS (Train Protection Warning System) with all progress targets being met. At the year-end, with the agreement of the HSE, 96% of the sites were commissioned and overall completion of the remaining installations within the current plan is scheduled for the end of 2003. The system is now delivering 90% of its safety benefit.

During the year, four track workers died in accidents, the same as the previous year. Clearly, this is unacceptable to the industry and our target is zero. The Joint Safety Working Group with contractors continues to review all working practices and procedures. In December 2002 a new works planning process known as RIMINI was introduced. It is designed to enforce safer works planning and reduce the amount of work undertaken whilst trains are operating.

We continue to work with a number of outside bodies, including the British Transport Police and Football in the Community, on our programme of liaison with youth groups and schools to impress on children and the young, the danger of playing on the railway and the consequences of vandalism. Malicious acts on the railways were 32% lower in 2002 than 2001. The number of trespasser fatalities and suicides fell slightly from the previous year. Although we have limited control over this category of incident, we targeted a number of risk mitigating activities including a focus to reduce access to the infrastructure.

Line-side scrap continues to be a significant issue for the Company. 71,000 tons were removed by January 2002, but continued effort and more efficient works planning are required to reduce line-side scrap's potential use by criminal trespassers.

Level crossing accidents represent one of the highest risks to train safety, and analysis is planned along with increased investment to reduce the risk of these accidents. The occurrence of vehicle incursions onto the railway has led to a review by ourselves, with local authorities and the Highways Agency, of the level of risk across these road / rail interfaces. A programme of protection works at key locations is being developed with costs to be shared.

Performance

The performance of the Network in 2002/03 was disappointing. After a good start the impact of weather in the autumn and early winter resulted in 14.7 million train delay minutes attributable to the infrastructure compared with 13.4 million in 2001/02.

These delays represented 55% of all train delays and this is clearly unacceptable. Train performance is significantly affected by Temporary Speed Restrictions and during the year reducing the number was made a key priority. By the year end the number had been reduced by 28% from a peak of 750 to 537.

In recent months new forecasting models have been developed to bring better understanding to the causes and impacts of the numerous influences on train performance. These will be used to focus our efforts on the most critical aspects of the network. Performance Improvement Teams have been established in each Region to identify the particular problem areas and action plans have been established.

A new industry code of practice, Service Recovery 2003, was introduced in February to reduce the duration and impact of incidents by improving co-ordination and co-operation between our Control Centres and those of the Train Operators.

We believe that the combination of these various initiatives will lead to better forecasting and performance.

Costs

Expenditure in 2002/03 was less than budget primarily due to a reduction in the forecast renewals spend, off-set in part by increased maintenance and West Coast Route Modernisation spend. The need for general increases in expenditure has been caused by a combination of the under-investment of the past and the increased traffic load during the last seven years. The network today is fragile and investment must increase to improve reliability.

However, we are targeting a 20% reduction in controllable costs by 2006/07. The basis for these reductions will be the application of the investment control procedures we have developed for projects in the last year, the application of business financial controls currently being introduced, the development of cost reducing measures with our suppliers and contractors and a reduction in our own operating expenditure.

Unit costs on maintenance and renewals have been steadily increasing. Reasons for these increases can be identified as general inflation, skill shortages, additional safety precautions, insurance, pension costs and improving standards. However we are concerned that possession utilisation efficiency is low and has plenty of room for improvement. We also believe we can improve the commercial relationships we have with our supply chain.

Asset Condition

We are planning a radical and cost effective change away from manual to mechanised inspection wherever possible. The principal benefits will be a system based on measurement that reduces the exposure of track workers to risk, which enables targeted preventative work, frees skilled staff to deliver actual maintenance activity and enables mechanised verification of the work executed.

This year we will introduce a new high-speed testing train, which will cover most of the High Speed Train network on a repeating fortnightly cycle. The train has the ability to travel at up to 125mph and carries specialist technical recording equipment which allows the vehicle to record track geometry and rail head condition. It uses video cameras to give engineers a comprehensive picture of the whole track and can record over 156,000 miles of track a year. This will provide the Company with up to date information on the condition of its assets recorded directly onto a computer database. An additional train is planned for the Southern Region whilst train-borne ultrasonic testing will provide improved data on rail integrity.

In order to meet our goal of a safe and reliable railway infrastructure we must first know the content and condition of that infrastructure. With that information we can then plan a timely maintenance and renewal regime. During the last year good progress has been made in updating and bringing together the various existing databases, whilst also developing and rolling out the Maintenance Management System (MIMs). This system will receive works orders based on Inspection Reports and then maintain a complete record of all works carried out to the infrastructure. It will also monitor regular inspection and maintenance, thus ensuring that any shortfalls are identified.

By the end of the year MIMs was in place at 42% of our depots and will be in place across all depots by the end of the coming year. It represents a considerable investment in engineering time and new data systems, but without this level of information we will not achieve the level of knowledge we require to fully understand and control our assets. The challenge going forward is to ensure both our staff and those of the contractors utilise this investment efficiently.

Asset Stewardship

The Company has decided to take more direct responsibility for maintenance activity on the infrastructure and has taken back responsibility for deciding what is done, when it is to be done and verifying its quality. The new relationship with our contractors is defined by the New Maintenance Programme (NMP), which has been introduced in our East Anglia Region and will be extended to all other regions.

In addition it is important that the Company becomes a more informed buyer of maintenance services and it was decided to take direct control in three areas, Reading, Wessex and East Midlands. The transfer will take place first in Reading, in the summer of 2003, the other two areas following later. These regions will provide exposure to routes where locomotive power is diesel (Reading contract), overhead lines (East Midlands) and third rail (Wessex). This move will give the Company a greater understanding of the operations, costs and associated issues of maintenance.

A central plank of future maintenance is automation. In the last year we have commissioned the first of our high output grinding trains which ensures the wheel/rail interface alignment is optimised and gauge corner cracking is kept under control. Rail grinding will extend rail life and so reduce whole life costs significantly. Two further plain line and five switch and crossing grinders are under order. In addition, high and medium output ballast cleaning trains have been ordered to improve the life and effectiveness of ballast.

With respect to the third element of track, namely sleepers, we have been trialling new equipment to automate the replacement of spot sleepers. The equipment offers significant cost savings for this important activity and more work is being undertaken to test its viability for use on the network.

To carry out any maintenance or renewal activity requires planned access and during the last year Delivery Planning Units have been put in place in each Region to ensure that we obtain the best use of time on the network with resources efficiently planned and used. We are confident that significant cost savings can be achieved through better possession utilisation.

Renewals

The cumulative under-investment in the network over many years has meant that we have had to increase our renewals activity during the last year. Our Business Plan forecasts the need for this level of activity to be maintained and even increased in the coming years. During 2002/03 we spent £2.5 billion on renewal. Of this total, £780 million was on the West Coast Main Line. Our Business Plan forecasts the need to increase total renewals to £3.9 billion by 2005/06. Looking ahead our Business Plan makes clear that current costs are unaffordable in the long-term and we must be prepared to challenge the assumptions behind costs, ensure they are robust and strive to deliver efficiencies wherever possible.

Major Projects

Good progress has been made on all our major projects in the last year. The restructuring of the management team and the introduction of Bechtel as Project Managers on the West Coast Route Modernisation has improved control and outputs. In addition station improvements were completed at Leeds and Manchester Piccadilly whilst the Cross Country Route Modernisation project and the West Anglia Route Modernisation project have progressed well. A £50million upgrade of the Chiltern Line at Aynho was completed on time and to budget.

The Thameslink 2000 scheme has had a disappointing year. We are working closely with the SRA to seek to resolve the planning issues raised by the Transport and Works Act planning inspector in his report. The start of construction on the project cannot now commence until these planning matters are resolved.

Major new signalling schemes have progressed at South Manchester, Dorset Coast and Horsham. These have all involved Computer Based Interlocking (CBI) as an alternative to Solid State Interlocking (SSI). Signalling is the fundamental safety critical performance control system and we therefore intend to introduce a central strategic control team to manage project specification and to ensure we maintain a long-term strategy and deliver value for money on all new signalling schemes.

Conclusions

In the last year, the Company has been transformed in ownership and structure. I welcome the newly appointed Members of Network Rail, as they join with us in our commitment to the nation's railway. It is early days for this new structure and I look forward to working together to build an open and constructive dialogue.

Of critical importance next year will be the satisfactory outcome to the Interim Review which will provide the financial foundation for the future health of the railway. The Company is working in close co-operation with the ORR and the SRA to ensure an open and transparent assessment can be made of our future needs.

The first steps have been taken to stabilise the core business of operations, maintenance and renewals. The challenges of the future have been clearly identified and the Company has plans in place to meet them.

I would like to thank our dedicated and loyal employees who continue to give their commitment and support to the railway. With the determined hard work and skills of our people and our improving relationships with all our stakeholders, I am confident that we can deliver the safe and reliable railway the nation expects.



John Armitt (Chief Executive)
4 June 2003

Finance Director's Review



In terms of financial stability and clarity the year ended 31 March 2003 can be seen as one of definite progress. Having been discharged from Special Railway Administration (followed immediately by its acquisition by Network Rail, the newly formed 'not for dividend' organisation accountable to key stakeholders from throughout the railway industry) the Company renamed itself Network Rail Infrastructure Limited. As its first vital step the Company successfully secured bridging finance and continues to develop a number of funding options to ensure the long term future of the UK railway network as outlined in the recently issued Network Rail Business Plan.

This Business Plan underlines the need for significant investment in the network. We recognise that these planned costs are unaffordable in the long term so we are working hard to bring costs down to the lowest possible level whilst maintaining our priority of a safe and reliable network. The Rail Regulator's statement of 27 June 2002 on the acquisition of the Company by Network Rail states that additional expenditure in the year to 31 March 2003 will be added to the Regulatory Asset Base. However, in future years we must make a case to the Rail Regulator to support such additional expenditure. The Company's future financial plans are therefore dependent upon the outcome of the Rail Regulator's review as our intention is to generate profits over the long term which we can use to reinvest in the network. Considerable progress has been made on a number of key performance measures during the year, and it is acknowledged that significant further work remains to meet our targets.

Financial performance

- Turnover was £2,965million in line with the prior year turnover of £2,912million. This included performance penalties of £395million (2001/02: £356million).
- Operating costs totalled £2,885million, an increase on the prior year restated costs of £2,391million. Included within operating costs are depreciation of £438million (2001/02 restated: £316million), staff costs of £561million (2001/02: £468million) and maintenance costs of £1,184million (2001/02: £951million).
- Profits of £45million were achieved from the sale of properties (2001/02 restated: £92million).
- The increase in average net debt in 2002/03 compared to the prior year has increased interest charges (before exceptional items of £106million) from £200million to £309million.
- Net debt increased from £6.3billion to £9.4billion in the year.
- Fixed assets as restated (see below) have increased from £9.2billion to £12.9billion.
- Net assets at 31 March 2003 totalled £1.75billion. (31 March 2002: £0.98billion).

Fundamental uncertainty – West Coast Route Modernisation (“WCRM”)

In preparing the financial statements the directors have considered a fundamental uncertainty relating to WCRM. During the year the Company continued to seek an agreement with Virgin Trains Limited (“Virgin”), the Strategic Rail Authority (“SRA”) and the Office of the Rail Regulator (“ORR”) on a revised contract and output specification in respect of WCRM. At the date of approval of the financial statements, the SRA has concluded its review of the optimal capacity utilisation of the West Coast Mainline and the infrastructure necessary to support this capacity, and has published its West Coast strategy for consultation. However, the ORR has still to review the SRA's proposals and consent to them.

There is a fundamental uncertainty as to the outcome of the ORR's review and it is not possible to quantify with any certainty the potential costs of any settlement with Virgin, or the extent to which they would need to be provided in the consolidated profit and loss account, consolidated balance sheet or Company balance sheet at 31 March 2003. In the opinion of the directors it would be seriously prejudicial for the Group to attempt to disclose any further information about the uncertainties or the potential financial effect of possible outcomes.

Exceptional items

The financial statements include £129million of exceptional charges comprising £106million of costs incurred through the early redemption of financial instruments on the refinancing by Network Rail, and £23million of one-off expenses relating directly to the Special Railway Administration order.

Contingent liabilities

Other than the fundamental uncertainty regarding WCRM discussed in note 1 to the financial statements the Company has no material contingent liabilities to report.

Taxation

The Company recorded a taxation credit for the year of £35million. (2001/02: charge of £111million).

Cashflow

During the year the Company's operating activities generated cash of £192million (2001/02: £498million).

Net interest paid amounted to £407million (2001/02: £355million).

Spending on fixed assets totalled £3.0billion (2001/02: £2.8billion) while receipts from fixed asset sales and capital grants contributed £0.1billion (2001/02: £0.1billion).

Net debt increased by £3.1billion to £9.4billion.

Changes in debt structure

The acquisition of the Company by Network Rail resulted in significant changes to the Company's debt structure. A number of existing financial instruments were replaced by a £9billion credit facility secured by Network Rail from a group of participating banks. The facility comprises a term loan and revolving credit facility. The term loan allowed the acquisition of the Company by Network Rail, payment of premia connected with the redemption of existing financial instruments and refinancing the indebtedness of the Company. The revolving credit facility is for the working capital purposes of the Group and to finance interest payments due on the facility.

Future funding

Network Rail's immediate financing needs are met by a range of short-term facilities from commercial banks, finance lessors and international lenders totalling £10.4 billion. Network Rail's core commercial financing will be completed over the coming months to meet Network Rail's working capital requirements through to implementation of the interim review in April 2004. This is in line with Network Rail's expectations when it took Railtrack PLC out of administration in October 2002.

Network Rail's commercial facilities benefit from a £21 billion package of standby support loans from the SRA of which £7 billion is undrawn standby support.

Over the next year, Network Rail expects to commence the process of refinancing its existing commercial facilities with long-term debt, including capital market issues. It also expects to continue working with the SRA to develop special purpose vehicle financing for enhancements to the rail network.

Accounting policies

There have been changes to accounting policies in respect of fixed assets and deferred taxation during the year. Both of these changes are outlined in detail in note 1 to the financial statements but the impact of the fixed asset policy change is significant in terms of the valuation recorded and the depreciation charged in the financial statements. The rationale behind the change and the consequential adjustments to prior year reported numbers, as well as the impact on the financial statements for the year under review are important to explain.

During the year, following extensive consideration, the Directors have determined that it is more appropriate to value the railway network at its depreciated replacement cost ("DRC"), make provision for impairment as necessary and depreciate it on a straight line basis over its estimated remaining weighted average useful economic life. A revaluation of the railway network and a re-estimation of its estimated remaining weighted average useful economic life will now be performed annually with external verification of the valuation and asset life carried out, where required, at least every five years. In the current year Ove Arup and Partners have reviewed Network Rail Infrastructure Limited's engineering assessment of the replacement cost, depreciated replacement cost and useful economic lives of all network assets and have confirmed in writing to the Directors that the basis upon which the assessment has been prepared is appropriate and that the resultant valuations and estimates are reasonable.

Under the previous accounting policy network fixed assets which comprise the railway network were included in the financial statements at historic cost with signalling, electrification and plant and machinery depreciated on a straight line basis and track, route structures, stations and depots depreciated using renewals accounting. Under renewals accounting the annual charge from the Company's asset maintenance plan was treated as the depreciation charge for the year for those assets with actual expenditure being capitalised as incurred.

In considering the appropriateness of a change in accounting policy and taking into account the Rail Regulator's statement of 27 June 2002 the Directors noted that DRC better reflected the economic value of the railway network and ensured that both the book value of fixed assets and the depreciation charge were accounted for on a consistent current cost basis.

In his statement the Rail Regulator indicated that he proposes to make certain adjustments to the regulatory asset base ("RAB") to reflect the additional expenditure on operating, maintaining and renewing the network in the two years ended 31 March 2003. Given that the RAB represents the value in use of the railway network (being, in effect, a discounted future cashflow calculation) the Directors consider that it gives a much clearer and more accurate economic assessment of the value to the business of the network as an asset. This clarity is particularly vital at a time when the RAB has increased significantly in a short period of time and is likely to continue to do so in the near future, a profile which could not be properly reflected under the previous accounting policy.

Whilst the change in policy produces a significant reduction in the annual depreciation charge, the revised policy is considered substantially more appropriate for the Company's current circumstances. The weighted average useful economic life of the railway network has been assessed at 25 years. This calculation is based on the estimated useful economic life remaining of all major asset categories and weights their proportion of the depreciation in accordance with their replacement cost valuation. The move to straight line depreciation for all asset categories contrasts with the previous renewals accounting approach where the relevant expenditure for the year was, in effect, the depreciation charge in the profit and loss account. Such renewals spend will now be charged to the profit and loss account over the estimated useful economic life remaining of the network. In the future, any renewals expenditure that is not allowed as an addition to the Regulated Asset Base and which exceeds the annual depreciation charge will be written off as an impairment charge.

It is worthy of note that the replacement cost of the network is estimated at approximately £180billion (after excluding the replacement cost of embankments, cuttings and tunnels) and the unimpaired depreciated replacement cost is estimated at £73billion. Were the unimpaired estimated depreciated replacement cost of the network to be depreciated on an identical basis over 25 years the resultant amount written off these assets for the year would be £2.92billion. As such the impact of the impairment down to the RAB causes an effective reduction in the depreciation charge of £2.48billion.

Whilst the remaining weighted average useful economic life is 25 years, this life is weighted significantly by the longevity and sizeable valuation of the structures portfolio. Other critical assets, such as track and signalling have estimated useful economic lives remaining of 12 and 11 years respectively. The current focus of the Company's renewals policy on track and signalling clearly reflects this balance of residual lifetimes.

In making this change the directors are also mindful of proposed amendments to UK accounting standards to make them consistent with international accounting standards, which do not permit renewals accounting. In addition it brings the valuation of fixed assets in the statutory accounts much closer in line with the valuation in the Company's regulatory accounts. For the year ended 31 March 2003 both sets of accounts will now report a comparable fixed asset valuation.

The change in accounting policy for the railway network has decreased depreciation and other amounts written off fixed assets for the year ended 31 March 2003 from £1,889million to £438million.

The change in accounting policy has resulted in a restatement of the comparative financial information for the year ended 31 March 2002, and opening shareholders' funds at 1 April 2002.

The effect of the change in accounting policy for the railway network is to improve the result in the consolidated profit and loss account for the year ended 31 March 2002 by £1,053million. This improvement comprised a reduction in depreciation of £1,599million and an increase in profit on sale of properties of £39million offset by an increase in tax on profit on ordinary activities of £585million.

The change in accounting policy for the railway network resulted in an increase in opening shareholders' funds at 1 April 2002 of £192million.

Interim determination

The ORR is undertaking an ongoing interim review of Network Rail's revenue requirements. The ORR has published two consultation documents which outline its proposed approach to the review, and the proposed financial and incentive frameworks. Our first key cost submission as part of this review has been the publication of the 2003 Business Plan, which includes our expenditure projections for the next three years to 2005/06. We have also provided the ORR with our initial longer-term projections covering the period from 2006/07 to 2011/12. The Interim Review is now moving into its second phase, in which we will be working to identify further opportunities for improved efficiency, to improve the robustness of our 10 year business plan, to carry out analysis of alternative expenditure scenarios and to support the ORR in an intensive programme of review by consultants to enable them to reach conclusions on our expenditure needs.

Treasury operations

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

The major financial risks that the Group faces are its exposure to fluctuations in interest rates and its ability to raise finance to meet its investment programme. Treasury ensures sufficient liquidity is available to meet the Group's needs, while reducing financial risks and prudently maximising interest receivable on surplus cash.

An annual funding plan approved by the Board sets out in detail the Group's 12 months' financing requirements and in broad terms the requirement for the next 5 years. It explains the options available together with their strengths and weaknesses and a recommended strategy. Group policy is to ensure that there are sufficient committed bank facilities and short term investments to cover, as a minimum, the next 12 months' funding requirements.

Treasury has a Board approved counterparty list which contains the entities with whom it may invest cash and transact derivative business. Limits are set with reference to published credit ratings. These limits dictate how much and for how long Treasury may deal with each counterparty and are monitored on a regular basis.

The Group's primary liquidity is provided by committed bank facilities. At 31 March 2003, the Group has £7.6billion in undrawn committed facilities.



Ron Henderson (Finance Director)
4 June 2003

Directors' Report

Principal activities

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

- Providing train operators with railway track access;
- Maintaining and renewing the infrastructure and undertaking major capital programmes; and
- Managing train timetabling, train planning and signalling.

Business review

<i>19 August 2002</i>	The Company acquired Network Rail (Spacia) Limited (formally Railtrack (Spacia) Limited) for consideration of £17million.
<i>1 October 2002</i>	The High Court ordered that the Company be discharged from Special Railway Administration.
<i>3 October 2002</i>	Network Rail Holdco Limited, a wholly owned subsidiary of Network Rail Limited purchased the entire share capital of the Company from Railtrack Group PLC for consideration of £500million (excluding acquisition expenses of £10million).
<i>3 February 2003</i>	The Company changed its name from Railtrack PLC to Network Rail Infrastructure Limited and reregistered as a private limited company.

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

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

Results

The loss before tax and exceptional items was £161million (2001/02 restated: profit of £433million) and the loss after tax including exceptional items was £255million (2001/02 restated: profit of £184million).

Share capital

On 14 October 2002 84,937 ordinary shares were issued to the Company's immediate parent company Network Rail Holdco Limited for consideration of £84,937,000.

Health and Safety

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

Previous incidents

The incidents which took place at Ladbroke Grove, Hatfield and Potters Bar are the subject of continuing police and HSE investigations, the outcomes of which are unknown at present.

Research and development

During the year the Group charged to the profit and loss account £8million (2001/02: £3million) on research and development. Other costs relating to significant development work have been capitalised in tangible fixed assets.

Directors and their interests

The present directors and brief biographical details can be found on pages 20 and 21. All the directors of the Company were appointed on the following dates:

Current Directors

Name	Position	Date of Appointment
Ian McAllister	Chairman	3 October 2002
Adrian Montague	Deputy Chairman	3 October 2002
John Armitt	Chief Executive	14 December 2001
Iain Coucher	Deputy Chief Executive	3 October 2002
Peter Henderson	Projects & Engineering Director	3 October 2002
Ron Henderson	Group Finance Director	3 October 2002
Chris Leah	Safety & Compliance Director	5 October 1998
David Bailey	Non-executive director	3 October 2002
Jim Comell	Non-executive director	14 December 2001
Charles Hoppe	Non-executive director	3 October 2002
Ross Sayers	Non-executive director	3 October 2002
Robert Smith	Non-executive director	3 October 2002

Other Directors, who served in the year to 31 March 2003

Name	Date of Appointment	Date of Resignation
Sebastian Bull	30 April 2001	3 October 2002
Richard Middleton	14 March 1994	3 October 2002
John O'Brien	21 December 2001	19 April 2002

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

Directors' Interests

The directors have no interests in the shares of the Company. Share options in the former holding company RT Group PLC (previously known as Railtrack Group PLC) have now lapsed.

Shareholder details

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

Equal opportunities and employee involvement

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

A survey was conducted by the Gallup organisation, commissioned by the Company, of employee engagement within the Group, involving the response by employees to a questionnaire in February and March 2003. A programme of communication of the results of the survey and training to improve employee engagement has been implemented. Another survey will be conducted in November 2003 with further surveys planned for subsequent years to monitor improvement in employee engagement.

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

Our equal opportunities policy is communicated to all employees. We are committed to offering our employees a fulfilling and challenging career in an environment free from discrimination, harassment, victimisation and bullying.

The Company is working with trade unions in the area of equality of opportunity and development of policy to promote best practice within the business. It is also a member of the Employers' Forums on Age and Disability.

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

Contributions for political and charitable purposes

During the year, the Company donated £621,000 to charitable organisations (2001/02: £533,000). A further £582,000 (2001/02: £725,000) was used to sponsor charitable and community related activities. No political donations were made in either year.

Creditors payment policy

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

At 31 March 2003 the Group's creditor days compared to the value of suppliers' invoices received in the year was 43 (2001/02: 43).

Auditors

At the Annual General Meeting of the Company, which will be held on 23 July 2003, a resolution will be proposed to reappoint Deloitte & Touche as the Company's auditors and to authorise the directors to fix their remuneration. Details of the fees earned by Deloitte & Touche during the period, for both audit and non-audit work, are set out in note 5 on page 55.

By order of the Board



Hazel Walker (Secretary)

4 June 2003

Board of Directors

John Armitt CBE, Chief Executive (3, 5 & 6) *

John Armitt, 57, is the Chief Executive of Network Rail having previously been appointed Chief Executive of Railtrack PLC after it was put into administration.

A civil engineer by training, he was previously Chief Executive of Costain Group plc, and before that Chief Executive of Union Railways.

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

David Bailey, 63, is the Strategic Rail Authority's non-executive Director on the Network Rail Board. With a procurement and logistics management background, he is the former Commercial Director for London Transport, having previously held various Director level roles within London Underground.

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

Jim Cornell, 63, was previously Group Managing Director, Infrastructure Services, British Rail.

Iain Coucher, Deputy Chief Executive (3 & 5) *

Iain Coucher, 41, is Deputy Chief Executive with responsibility for all operational matters. Previously, he was Chief Executive of Tube Lines, one of the preferred bidders for the London Underground PPP. For sixteen years, he worked for EDS, and for three years was seconded to TranSys as Chief Executive.

Chris Leah, Safety and Compliance Director (3) *

Chris Leah, 55, is responsible for safety, health and environmental management, having previously served as Railtrack Director, Operations from 1998. He has been on the board of the Company since 1998 and acted as the Director, North West Zone, between 1994 and 1997.

Peter Henderson, Projects & Engineering Director (3 & 5) *

Peter Henderson, 49, is Network Rail's Projects & Engineering Director, Peter has over 20 years rail experience, most recently at Bechtel where he was Projects Director Rail, which included responsibility for engineering. He spent sixteen years with the Hong Kong Mass Transit Railway Corporation, latterly as Head of Major Projects.

Ronald Henderson, Group Finance Director (3 & 5) *

Ronald Henderson, 57, the Group Finance Director, was formerly Group Finance Director of BICC plc, Finance Director of Balfour Beatty, and most recently Chief Executive of Tuberail.

Charles Hoppe, Non- Executive Director (2 & 6) *

Charles Hoppe, 68, is the former Vice President, Operations and Facilities Planning, United States Railway Association, Senior Vice President of Booz, Allen & Hamilton's worldwide rail consulting practice, and President of the Long Island Rail Road.

Ian McAllister CBE, Chairman (2 & 4) *

Ian McAllister, 59, is the Company's non-executive Chairman having previously been Chairman and Managing Director of Ford Motor Company Limited. Ian is also Chairman of the Carbon Trust, Deputy Chairman of the Qualifications and Curriculum Authority and senior non-executive Director of Scottish & Newcastle plc.

Adrian Montague CBE, Deputy Chairman (1, 2, & 5) *

Adrian Montague, 55, is Network Rail's Deputy Chairman – a non-executive role. He is Chairman of British Energy plc and Michael Page International and a senior advisor at Societe Generale.

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

Ross Sayers, 61, is a former Chairman and Chief Executive of New Zealand Railways Corporation and previously Chairman and Chief Executive of the State Rail Authority of New South Wales, Australia, and currently, Chairman of Associated British Ports Holdings plc.

Sir Robert Smith, Non Executive Director (1 & 2) *

Sir Robert Smith, 58, is currently Chairman of Weir Group plc and former Vice Chairman Deutsche Asset Management, Chief Executive Morgan Grenfell Asset Management and Chief Executive of Morgan Grenfell Private Equity.

* Numbers against directors' names indicate the committees of the Board on which each of them serve, as follows:

1. Audit Committee
2. Remuneration Committee
3. Executive Committee
4. Nomination Committee
5. Property Board
6. Safety Health & Environment Committee

Directors' Remuneration Report

The Directors' Remuneration Report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002 ("the Regulations") which introduced new statutory requirements for the disclosure of directors' remuneration for listed companies in respect of periods ending on or after 31 December 2002. The report also meets the relevant requirements of the Listing Rules of the Financial Services Authority and describes how the Board has applied the Principles of Good Governance relating to directors' remuneration. The Regulations require certain information shown in this report to be subject to audit. Accordingly, the table of Directors' emoluments and the information in respect of pension benefits have been audited, as referred to in the Independent Auditors' Report on pages 43 and 44. All other information in this report is unaudited.

The Remuneration Committee

The Remuneration Committee of the Boards of both the Company and Network Rail Limited comprises entirely of both the Companies' non-executive directors, namely:

- Sir Robert Smith – Chairman
- David Bailey
- Jim Cornell
- Adrian Montague
- Charles Hoppe
- Ian McAllister
- Ross Sayers

The Committee will meet at least three times a year. Since being formed as a committee of the Board in October 2002 (in the period to 31 March 2003), it met 6 times due to the need to consider a large number of significant remuneration matters. The Group Company Secretary is the secretary to the Committee.

The Committee is responsible for determining all matters concerning the remuneration and incentivisation of the executive directors of the Company. This includes making decisions in respect of the framework of the executive directors' remuneration and its cost and determining, on behalf of the Board, specific remuneration packages for each of the executive directors and, with the abstention from voting respectively by the Chairman and Deputy Chairman, the remuneration packages for each of the Chairman and Deputy Chairman. It also decides upon the form and content of the executive directors' management incentive plan for each financial year.

Additionally the Committee determines the framework of certain senior executive employees' remuneration as well as the form and content of their management incentive plan for each financial year.

After the establishment of the Committee, upon the acquisition by Network Rail Limited in October 2002, the Committee reviewed the total remuneration packages of executive directors and senior executive employees with advice from Deloitte & Touche's compensation consultancy division having been commissioned by the Committee: in particular Deloitte & Touche conducted a benchmarking process of basic salaries. Also the Committee reviewed the policies on other elements of the remuneration package with further assistance from Deloitte & Touche.

Following a decision by the Audit Committee that Deloitte & Touche as the Company's auditors should not be engaged by the Company to perform work other than audit or tax services and such other services as the Audit Committee approve, the Committee commissioned consultants, New Bridge Street, to advise on the draft management incentive plan for 2003/04.

Service contracts for the executive directors were prepared on behalf of the Committee by the Group Company Secretary with advice and drafting of terms by solicitors, Linklaters, commissioned by the Group Company Secretary on behalf of the Committee for this purpose.

Executive Directors' Remuneration Policy

Network Rail's remuneration strategy is to create the potential to reward outstanding performance at a competitive market rate when compared to the market place based on individual contribution and the overall success of Network Rail in meeting the objectives of the Business Plan.

The objectives of the Network Rail remuneration policy are to:

- Ensure that performance is based on competitive practice in the market where Network Rail needs to attract competent individuals;
- Enable Network Rail to recruit, retain and motivate individuals with the right skills, knowledge, experience and competencies;
- Have the potential to reward individuals at a competitive market rate based on individual performance and the overall success of Network Rail;
- Establish a total remuneration approach, defined as the sum of base salary, incentives and benefits;
- Clearly identify the levels of remuneration awarded for comparable roles in the market;
- Be responsive to external market demands, as the comparator group for roles will vary according to the sectors and specialist skills Network Rail needs to acquire;
- Use variable pay through the availability of incentives to form a significant part of total remuneration to ensure that each individual's reward is clearly linked to the successful delivery of Company objectives.

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

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

Reward Package

The current package for executive directors under their service agreements with the Company comprises the following elements:

Basic Pay

The aim is to ensure that salaries are competitively set in relation to similar jobs in appropriate companies within the FTSE 350.

Current salaries for the executive directors, following the most recent salary review in November 2002 are:

Executive Director	Salary
John Armitt	£450,000
Iain Coucher	£400,000
Peter Henderson	£300,000
Ron Henderson	£300,000
Chris Leah	£300,000

Annual Incentive

Railtrack PLC in Administration

The directors of Railtrack PLC (now known as Network Rail Infrastructure Limited) in the period up to 3 October 2002 had an entitlement to incentives agreed with the Company's Special Railway Administrators that covered the period of administration. These were based on:

- Successful transfer of Railtrack PLC to a new owner and the ending of administration
- Retention of essential skills and management within the business to ensure its operational viability

These incentives were paid to the executive directors of Railtrack PLC (as at 2 October 2002 pre-acquisition by Network Rail) as appropriate upon the completion of the transfer to the Network Rail Group and are detailed in each individual's remuneration statement.

Network Rail

It is a network licence condition for the Company to introduce an incentive plan. For 2002/03 Network Rail established an Interim Management Incentive Plan (MIP) in respect of the period from 3 October 2002 to 31 March 2003. The MIP applied to all executive directors of the Company and certain senior executives who joined the Company in October 2002. Details of the MIP were published in March 2003. The existing Railtrack senior incentive scheme continued to apply to existing Railtrack senior executives (other than directors).

2002/03 Management Incentive Plan

Principal Terms

The overriding purpose of the MIP was to create the potential to reward outstanding performance based on individual contribution and the overall success of Network Rail in meeting the objectives of the Business Plan.

The MIP comprised the following two key elements:

- Business Performance Plan – Annual Bonus based on business performance reflected in five key measures and an override
- Personal Performance Plan – Annual Bonus based on personal performance against individual targets and an override

MIP Performance Criteria

Participants were eligible to receive bonuses based on demanding business and personal performance measures, no bonus being payable if Network Rail failed to reach the minimum performance level under the Business Performance Plan. Furthermore, the Committee could reduce incentive payments to take account of safety factors or other issues.

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

MIP Business Performance Measures

The amount payable was calculated by reference to performance against the following five output measures:

- Public performance (weight 25%) - this is the percentage of trains arriving on time over the twelve months to 31 March 2003 as published in National Rail Trends. "On time" is defined as running as planned and arriving less than 5 minutes late at final destination or less than 10 minutes late for inter-city operators.
- Passenger capability (weight 10%) - this is a volume based measure dependant on the growth in actual passenger train miles and passenger train operators' revenue from fares as reflected in the Regulator's volume incentive.
- Freight capability (weight 10%) - this is a volume based measure dependant on the growth in freight train miles and tonne miles as reflected in the Regulator's volume incentive.
- Financial efficiency (weight 30%) - this is a measure of the efficiency of operations, maintenance, track renewals and other key central expenditure.
- Asset stewardship (weight 25%) – this is an index which reflects the overall status of a number of contributory indicators of the condition of the network (including the number of Broken Rails, Level 2 Exceedences, Number of Signalling Failures, Poor Track Geometry, Traction Power Component Failures and Station Condition).

The Committee was also required to consider the Company's net debt and determine, at its discretion, the amount by which any award should be reduced.

MIP Personal Performance Measures

The amount payable to participants under the Personal Performance Plan – Annual Bonus was calculated by reference to the following personal measures in accordance with a calculation procedure:

- *Employee engagement (weight 20%)*
A measure of the level of employee engagement with the business of Network Rail across all business areas (good levels of employee engagement are reflected in improved retention of employees, business unit productivity, profitability, customer service and safety performance).
- *Two Departmental Key Performance Indicators (KPIs) (weight 20% each)*
Business Unit objectives have been set for each executive using the most appropriate KPIs. For example, the Chief Executive and Deputy Chief Executive are incentivised to reduce the level of Network Rail-caused train delays.
- *Financial measure (weight 20%)*
targets in respect of Business Unit Financial Measures have been assigned to each executive.
- *Individual assignments (weight 20%)*
objectives in respect of individual assignments have been set based on the delivery of Action Plans designed to transform Network Rail.

MIP Potential Entitlement

For each measure, the target level of performance was based on assumptions that were discussed between SRA and Network Rail based on available information prior to the acquisition of Railtrack. They were intended to reflect stretch targets for the level of performance that might be achieved in the short term. The potential entitlement if these targets were met was 40% of basic salary. In each case a minimum level of performance was set below which no incentive payment would be made and a maximum level of performance was set above which no further incentive payment would be made. In the event that the very highest levels of performance are attained, the maximum possible entitlement was 80% of basic salary. The remuneration potential was benchmarked against external comparable organisations.

MIP Award

Whilst incentive plan awards will be made to existing senior executives (other than executive directors) under the Railtrack incentive plan for 2002/03 that was in place at the time of acquisition of the Company, the Committee has determined that it would be inappropriate to make awards under the MIP for 2002/03 to any of the executive directors due to the relatively poor train performance even though other targets within the MIP were achieved.

2003/04 Management Incentive Plan

The terms of the incentive arrangements for 2003/04 are as follows:

MIP Principal Terms

The purpose of the MIP for 2003/04 and beyond is to create the potential to reward outstanding performance based on individual contribution and the overall success of Network Rail in meeting the objectives of the Business Plan. The plan will include annual and long term elements to ensure that the incentive regime applies to the operation of the business and the future requirements of the business. At this time the Committee have determined the annual elements of the incentive plan for 2003/04. The long term element of the plan will be developed during the current financial year and will be formed as greater clarity is gained of the long term requirements for the business as part of the Regulator's Interim Review process.

MIP Performance Criteria

Participants are eligible to receive bonuses based on demanding business performance measures. The 2003/04 MIP uses the KPIs from the 2003/04 Business Plan as objectives with the provision for an override based on the net debt of the business. Importantly, no bonus is payable if the Company fails to reach the minimum performance level under the Business Performance Plan. Furthermore, the Committee may reduce incentive payments to take account of safety factors or issues.

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

MIP Business Performance Measures

The business performance measures are detailed below. The amount payable is calculated by reference to performance against the following output measures:

- Public performance (weight one third) - this is the percentage of trains arriving on time over the twelve months to 31 March 2004 as published in National Rail Trends. "On time" is defined as running as planned and arriving less than 5 minutes late at final destination or less than 10 minutes late for inter-city operators.
- Financial efficiency (weight one third) - this is a measure of the efficiency of operations, maintenance, track renewals and other key central expenditure.
- Asset stewardship (weight one third) – this is an index which reflects the overall status of a number of contributory indicators of the condition of the network (including the number of Broken Rails, Level 2 Exceedences, Number of Signalling Failures, Poor Track Geometry, Traction Power component Failures and Station Condition).

The outputs set out in the 2003/04 Business Plan need to be achieved as a threshold for bonus payments. The maximum bonus can be earned by delivering the 2004/05 business plan one year early.

The Committee is also required to consider the Company's net debt and determine, at its discretion, the amount by which any award should be reduced.

The Committee has considered whether to set individual performance measures for the directors for 2003/04. It has concluded that, in view of the collective accountability of the directors and the need to establish the stability of the organisation, this is not appropriate to do so this year for the executive directors. Other senior executives will have individual performance measures.

MIP Potential Entitlement

The potential bonus entitlement if the threshold target is achieved is 18% of basic salary. In the event that the very highest levels of performance are attained, the maximum possible entitlement is 60% of basic salary. The remuneration potential has been benchmarked against external benchmarks for comparable organisations.

Long-term Incentive

Given that the Company's ultimate parent company, Network Rail Limited, is a company limited by guarantee it is not possible to use traditional long-term incentives such as share options due to the absence of shares as the reward method. The Committee formed the view, therefore, that time needed to be taken for consideration of what is appropriate in place of shares. As such there were no long-term incentives for the year 2002/03.

Equally there are currently no long-term incentives in place for 2003/04 as the Committee considers that in order for an effective long-term scheme to be introduced any decision on this matter will need to reflect the outcome of the Rail Regulator's Interim Review later this year.

It is the intention of the Committee, therefore, to develop long-term incentives after further consideration to be given during 2003 as to how this is best achieved. These incentives will be based on relevant long-term improvement in business performance that are challenging and appropriate at the time. Further the targets will reflect the business plan, sponsor requirements and the funding determined by the Rail Regulator's Interim Review. The incentives are likely to be deferred cash payments with awards if payable made after each complete three year period. The long-term incentive targets developed will then be applied retrospectively to cover the three year period from the start of the 2003/04 financial year until the end of the 2005/06 financial year.

Regulatory MIP Statement

In compliance with the Company's network licence requirement a statement was published by the Committee in March 2003 detailing the contents of the executive directors' Management Incentive Plan for 2002/03. A statement for the Management Incentive Plan for 2003/04 will also be published in June 2003.

Executive Directors' Service Agreements

Railtrack PLC in Administration

Whilst Railtrack PLC was in Special Railway Administration the Administrators sought to secure continuity of management of the Company. To achieve this specific contractual terms were applied to directors that provided the following features:

- Continuity of management stewardship until the end of administration
- A potential for clean break for either party at the end of administration

As a result incentives were provided as part of the contractual terms which were payable on the completion of the period of administration and successful transfer of the business to the new legal entity. Details of the incentives paid under these contractual entitlements put in place by the Administrators are shown in the table of remuneration on page 32.

Network Rail

All the executive directors have since entered into new service agreements following the acquisition of the Company effective from 3 October 2002. In drawing up these agreements the Committee took into account as many as possible of the provisions of the UK listing authority's corporate governance code and the recommendations contained within the joint statement of the Association of British Insurers and the National Association of Pension Funds of best practice on executive contracts and severance published in December 2002.

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

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

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

Non-executive directors do not have service agreements and, in accordance with the Company's articles of association, their appointments may be terminated at any time without compensation.

External Appointments

The Company recognises that executive directors may be invited to become non-executive directors of other companies and that such appointments can broaden their knowledge and experience, to the benefit of the Company. An individual director will normally be required to account to the Company for all fees received in respect of such directorship unless otherwise approved.

Non-Executive Directors' Remuneration

The non-executive directors of the Company are also the non-executive directors of Network Rail Limited. Each non-executive director has a letter of appointment with either the Company or Network Rail Limited but not both companies nor do other contractual provisions or remuneration arrangements exist in relation to their directorships of any other company within the Network Rail Group. For the purpose of this remuneration report and the remuneration report of Network Rail Limited, therefore, the following provisions set out the terms of Network Rail Limited's or Network Rail Infrastructure Limited's letters of appointment of the non-executive directors as appropriate and they also appear in the Annual Report of Network Rail Limited.

The fees of the non-executive directors are agreed by the Board. They are designed to recognise the significant responsibilities of directors and to attract individuals with the necessary experience and ability to make an important contribution to the Company's business. The fees, which are neither performance related nor pensionable, are comparable with those paid by other comparable private sector companies.

Non-executive directors receive a fee only together with their expenses for attending meetings of the Board and other meetings and events. No additional fees are paid where a non-executive director is a member of or chairs a board committee. They do not receive any other benefits from the Company (save as shown in the table on page 31). The non-executive directors' fees are set by the Board, having regard to benchmarking of comparable companies.

Current annual fees for the non-executive directors are:

Non-Executive Director	Note	Fee
Ian McAllister		£210,000
Adrian Montague		£70,000
David Bailey	1	£35,000
Jim Cornell	2	£35,000
Charles Hoppe	1	£35,000
Ross Sayers	1	£35,000
Robert Smith	1	£35,000

1. Received annual fee of £33,000 pro rata, for period from August 2002 to January 2003.

2. Received annual fee of £40,000 for 2002/03.

Directors' emoluments (audited)

Disclosure of directors' remuneration by type

Post 3 October 2002

Name	Note	Salaries and Fees £'000	Bonuses £'000	FURBS & AVC payments by the Company £'000	Benefits £'000	2002/03 Total £'000
J Armitt		211	-	47	10	268
D Bailey	1	21	-	-	-	21
J Cornell		19	-	-	-	19
I Coucher		197	-	57	6	260
P Henderson		143	-	42	6	191
R Henderson	2	193	-	42	6	241
C Hoppe	3	22	-	-	-	22
CR Leah		141	-	50	9	200
I McAllister		99	-	-	-	99
A Montague		22	-	-	-	22
R Sayers	3	22	-	-	-	22
R Smith	4	25	-	-	-	25
Total *		1,115	-	238	37	1,390

* Other emoluments received in respect of the acquisition of Railtrack PLC by Network Rail Limited are detailed below.

The above table includes the following amounts that relate to services provided by directors to the Company's ultimate parent company, Network Rail Limited, prior to acquisition of the Company:

1. Includes £5,000 for the period from 15 August 2002 to 2 October 2002;
2. Includes £52,000 for the period from 12 August 2002 to 2 October 2002;
3. Includes £6,000 for the period from 1 August 2002 to 2 October 2002;
4. Includes £3,000 in respect of acting as the director representative for Network Rail Limited on the Membership Selection Panel and £6,000 in respect of the period from 1 August 2002 to 2 October 2002.

Pre 3 October 2002 £000's

Name	Note	Salaries and Fees £'000	Bonuses £'000	FURBS & AVC payments by the Company £'000	Compensation for loss of office £'000	Benefits £'000	2002/03 Total £'000
J Armitt	1	239	225	23	-	6	493
J Cornell		21	-	-	-	-	21
CR Leah	2	159	451	52	-	10	672
GSM Bull	3	162	216	79	300	5	762
RJ Middleton	4	166	189	51	300	10	716
J O'Brien		58	62	-	36	3	159
Total		805	1,143	205	636	34	2,823

1. Bonus refers to payments for the successful transfer of Railtrack PLC out of administration
2. Bonus refers to £150,000 retention payment, £300,000 loyalty payment and £500 all employee bonus
3. Bonus refers includes £150,000 retention payment, £65,000 executive bonus and £500 all employee bonus
4. Bonus includes £150,000 retention payment, £38,621 executive bonus and £500 all employee bonus

In addition to the sums disclosed in the tables above, the following sums paid by the SRA are required to be disclosed as payments in respect of the services of particular directors:

1. Ian McAllister received fees totalling £180,000 for his services between 1 April 2002 and 2 October 2002 in connection with developing the bid for, and completing the acquisition of, Railtrack PLC.
2. Societe Generale (of whom Adrian Montague is an employee) received fees totalling £1,240,000 (excluding VAT) for Adrian Montague's services between 1 April 2002 and 2 October 2002 in connection with developing the bid for, and completing the acquisition of, Railtrack PLC.
3. Iain Coucher received fees totalling £480,750 (excluding VAT) for his services between 1 April 2002 and 2 October 2002 in connection with developing the bid for, and completing the acquisition of, Railtrack PLC.

Societe Generale (of whom Adrian Montague is an employee) also received fees from Network Rail Infrastructure Limited totalling £80,000 (excluding VAT) for Adrian Montague's services between 1 October 2002 and 30 November 2002 in connection with his services as a director of Network Rail Infrastructure Limited. Adrian Montague received his non-executive fee from the Company as detailed in the table on page 31 with effect from 1 December 2002.

Directors' Remuneration Comparison: 2002/03 against 2001/02

	2002/03 total £'000	2001/02 total £'000
Current directors		
J Armitt	761	121
D Bailey	21	n/a
J Cornell	40	9
I Coucher	260	n/a
P Henderson	191	n/a
RA Henderson	241	n/a
C Hoppe	22	n/a
CR Leah	872	314
I McAllister	99	n/a
AA Montague	22	n/a
RE Sayers	22	n/a
R Smith	25	n/a
Ex-directors		
GSM Bull	762	359
RJ Middleton	716	316
J O'Brien	159	107
Total	4,213	1,266

The total amount of directors' emoluments for services provided solely to the Company during the year was £4,135,000 (2001/02: £1,266,000 excluding directors who resigned in 2001/02).

Directors' pensions (audited)

The table below shows the pension entitlement from the Network Rail Section of the Railways Pension Scheme (RPS), and unapproved arrangements where appropriate, of each executive director of the Company during the year ended 31 March 2003, together with the increases in those benefits during the year, calculated using the accrued benefit basis.

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

The benefits shown below for Iain Coucher, Ron Henderson and Peter Henderson under columns (B), (G) and (J) represent the accrual of benefits from the date of appointment to the Board. Columns (A), (F), (H) and (K) relate to the full year where these directors were employed by the Company prior to being appointed to the Board. Richard Middleton, Sebastian Bull and John O'Brien resigned from the Board during the year. The figures shown for them represent the accrual of benefits to the dates of their resignations.

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

Directors participate in the Railways Pension Scheme. In addition, some directors are entitled to additional pension benefits. The method of providing additional pension benefits was changed during 2002/03. Previously additional benefits were unfunded - the Company charged an amount to Profit and Loss each year, and thus accrued a reserve in the balance sheet. As a result of the change, the reserve was exchanged for an equivalent payment to a funded pension arrangement. The intention was to broadly maintain the value of benefit. Future contributions are also made to this arrangement.

The increases in annual benefits and accrued benefits at 31 March 2002 as disclosed in the Railtrack PLC accounts as at that date included an element of unfunded defined benefits. The disclosure below incorporates only defined benefits in the RPS, with defined contribution benefits shown separately below.

Core Pension Benefits

	Gross increase in accrued RPS pension (A) £	Increase in accrued RPS pension net of inflation (B) £	Total accrued RPS pension at 31/03/03 (C) £	Transfer value of accrued RPS pension at 31/03/02 (D) £	Transfer value of accrued RPS pension at 31/03/03 (E) £	Total change in transfer value during period (F) £
Current directors						
J Armitt	1,628	1,614	2,086	36,431	56,658	15,329
I Coucher	781	777	781	-	5,380	2,757
P Henderson	799	799	799	-	7,618	4,995
R Henderson	799	799	799	-	13,340	10,717
C Leah	65,031	61,262	186,824	3,352,722	3,147,311	(219,823)
Ex-directors						
R Middleton	2,555	196	135,354	1,717,588	1,329,854	(393,710)
S Bull	866	775	6,015	77,962	77,578	(2,666)
J O'Brien	187	156	4,686	64,491	85,110	20,371

1. Pension accruals shown are the amounts which would be paid annually on retirement (or earlier leaving) based on service to the end of the year.
2. Transfer values as at 31/03/2002 (D) and 31/03/2003 (E) have been calculated in accordance with version 1.5 of guidance note GN11 issued by the actuarial profession.
3. The change in the transfer value (F) includes the effect of fluctuations in the transfer value due to factors beyond the control of the Company and directors, such as stock market movements. It is calculated after deducting the director's contributions.
4. I Coucher, R Henderson and P Henderson were directors for part of the year only, appointed on 3 October 2002. The directorships of R Middleton and S Bull ceased with effect from 3 October 2002 and the directorship of J O'Brien ceased with effect from 19 April 2002. The combined code requires (B) to reflect only the part year, whilst the other disclosures relate to the full year.

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

In addition to members' benefits, dependants' pensions are paid to a surviving spouse on death after retirement in line with those paid to all members of the Railways Pension Scheme. The dependant's pension is payable at the rate of one half of the member's pension accrued at the date of death, or in payment if death occurs after retirement, although on death after retirement the effect of any commutation for a tax-free cash sum is ignored when calculating the dependant's pension. In addition, the Scheme pays pensions to surviving children. Where two children survive, a pension additional to the dependant's pension is paid at the rate of $\frac{3}{8}$ of the member's pension. Children's pensions are paid to the age of 18 or a later age, at the discretion of the Network Rail Section Pensions Committee, if the child is in full time education or handicapped. The Railways Pension Scheme provides guaranteed increases to all pensions in payment and deferment in line with the Retail Prices Index.

A payment of £23,937 was paid to the RPS to augment benefits for John O'Brien, providing an additional deferred pension as at his date of leaving of £2,164 per annum. John O'Brien also received a taxable lump sum of £36,484. Of the total payment of £60,421 made to or on behalf of John O'Brien, the amount attributable to the accounting period was £10,090.

In addition, and in keeping with the Company's policy to other senior employees recruited mid-career, John O'Brien has been granted an additional period of membership in the Network Rail Section of the Railways Pension Scheme. This additional period of membership accrues uniformly over the executive's service to the scheme retirement age of 60 and the benefits of additional membership accrued to 31 March 2003 are reflected within the table, as is the additional personal contribution paid by John O'Brien.

The executive directors contribute to the Railways Pension Scheme at the same rate as other members of the Network Rail Section.

Additional pension benefits

As described above, some directors are entitled to additional pension benefits. Where a director is entitled to such benefits, the director can choose the extent to which the gross payment is made to the pension arrangement, or taken as cash. Future contributions are at a pre determined level, and the amount has been notified to each director. The initial contributions in respect of benefits accrued prior to the year under review are shown below, along with payments made during the year.

The Railways Pension Scheme also operates a matching Additional Voluntary Contribution facility, whereby voluntary contributions paid by members are matched by equivalent payments from the Company, up to certain limits. These payments are also shown below.

	Contributions to additional pension provision whilst a Director during the year (G) £	Contributions to additional pension provision during whole year (H) £	Payments to additional pension provision in respect of prior years (I) £	Matching additional voluntary contributions whilst a Director during the year (J) £	Matching additional voluntary contributions during whole year (K) £
Current directors					
J Armitt	48,028	48,028	6,555	21,765	21,765
I Coucher	56,781	56,781	-	-	-
P Henderson	41,987	41,987	-	-	-
R Henderson	41,987	56,682	-	-	-
C Leah	93,890	93,890	315,162	7,974	7,974
Ex-directors					
R Middleton	47,850	47,850	426,326	3,211	3,211
S Bull	76,802	76,802	284,734	2,525	2,525
J O'Brien	-	-	-	105	105

I Coucher, R Henderson and P Henderson were directors for part of the year only, appointed on 3 October 2002. The directorships of R Middleton and S Bull ceased with effect from 3 October 2002 and the directorship of J O'Brien ceased with effect from 19 April 2002. The combined code requires (G) and (J) to reflect only the part year, whilst the other disclosures relate to the full year.

None of the non-executive directors is a member of the Network Rail Section of the Railways Pension Scheme and they have no other pension entitlements.

Performance graph

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

Directors' interests

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

On behalf of the Remuneration Committee



Sir Robert Smith (Chairman, Remuneration Committee)
4 June 2003

Corporate Governance Report

It is a condition of the Company's network licence that, from 3 October 2002, it complies with the governance principles contained in the code annexed to the UK Listing Authority's listing rules ("the Code"). The Code includes a requirement for companies to make statements on corporate governance in their annual reports.

In January 2003 the Higgs Report was published on the role of non-executive directors. In reviewing its governance procedures, the Board has incorporated as many of the recommendations of the Higgs Report as practical given that the Higgs Report has not yet been formally adopted by the UK Listing Authority.

Also, in January 2003 the Smith Report on audit committees was published and again the recommendations of that report have been adopted by the Company. In particular, the terms of reference and conduct of the Audit Committee of the Company include the principles of that Report.

The following comments are, therefore, included to demonstrate how the Board has been implementing compliance with the Code, taking into account that the Company was in Special Railway Administration during the year until 1 October 2002 and its entire share capital was acquired by Network Rail Limited on 3 October 2002 when it became a subsidiary in the Network Rail group of companies.

Corporate governance principles

The Board considers that good corporate governance is central to achieving the Company's objectives and the principle of safeguarding stakeholders interests in the rail infrastructure. The Company is also committed to the highest standards of business behaviour.

The information contained within pages 20 and 21 shows that the Company is led and controlled by a board comprising five executive and seven non-executive directors with wide experience both within the rail industry and generally. The Strategic Rail Authority has rights under the Articles of Association to appoint a Special Director to the Board of the Company.

Board of Directors

The appointment of directors is to be considered by the Board. Under the Articles of Association of the Company the directors are not subject to retirement by rotation (as required under the Code, due to it being a wholly owned subsidiary of Network Rail Limited). Under the provisions of the Articles of Association of Network Rail Limited, however, all new directors, save the Special Director, must retire by rotation, and may stand for re-election by the members of the Company at least every three years.

The non-executive directors constructively challenge and contribute to the development of the strategy of the Company as well as scrutinising the performance of management in meeting agreed goals and objectives and monitoring the reporting of performance.

The Board considers that all the non-executive directors are independent of the Company. Given the definition of "independent" contained within the Higgs Report it is appropriate to disclose that Jim Cornell was, until 1996, a director of British Rail. He currently receives a pension from the Network Rail section of the Railways Pension Scheme. He is also a member of the Railway Heritage Trust. The Board considers, however, that as a non-executive director of Network Rail, Jim Cornell is independent as he was not an employee or executive director of Railtrack PLC. Furthermore the corporate structure of Network Rail

Limited, being a 'not for dividend' company, eliminates any potential or perceived conflicts between him being a non-executive director of the Company and receiving a pension from the Company. Jim Cornell having held various senior roles within British Rail before retiring on the creation of Railtrack PLC, is a highly experienced and respected railwayman who contributes considerable knowledge to the Company. This enables him to challenge constructively and effectively operational matters within the Company as well as participating in the full range of responsibilities of a non-executive director.

None of the non-executive directors are members of more than three committees of the Board except David Bailey who is a member of the Nominations and Remuneration Committees of the Board due to his nomination to the Board in accordance with the Company's Articles of Association as the SRA's Special Director. Further by request of the SRA he is also a member of the Audit and Safety, Health & Environment Committees.

Board processes

The Board is scheduled to meet ten times a year and a format is prepared and agreed, which ensures that the directors are able to review corporate strategy regularly and the operations and results of the business units within the Company and to discharge their other duties.

The Board has established six standing committees with defined terms of reference as follows:

The **Safety, Health & Environment Committee** is chaired by Jim Cornell and comprises three other non-executive directors and the Chief Executive. The Committee's role is to monitor the safety, health and environmental responsibilities of the Company. It has met once between 3 October 2002 and 31 March 2003. In addition to this committee, reflecting the recommendations in the Cullen Report, two executive committees have been set up, dealing with strategic and tactical safety matters. Prior to the creation of these committees, other executive safety committees were in place, which met monthly. Further, the Board receives a report on safety, health and environment matters at each of its scheduled meetings.

The **Audit Committee** is chaired by Ross Sayers and comprises three other non-executive directors whose role it is to satisfy themselves that financial information is accurate and that financial controls and systems of risk management are robust and defensible. It has met twice between 3 October 2002 and 31 March 2003.

The **Remuneration Committee** is chaired by Sir Robert Smith and comprises six other non-executive directors who determine appropriate levels of directors' and senior executives' remuneration. It has met six times between 3 October 2002 and 31 March 2003. The Committee's Report is contained in pages 22 to 36.

The **Nomination Committee** is chaired by Jim Cornell and comprises two other non-executive directors who are responsible for considering and recommending the appointment of new directors and other significant functions. The Committee has met once between 3 October 2002 and 31 March 2003 to consider its terms of reference for recommendation for adoption to the Board and to consider potential candidates for the non-executive and special advisor positions on the Network Rail Property Board. Candidates for these positions were sought through external management search sources due to the highly specialised and sensitive nature of the positions.

The **Network Rail Property Board** is chaired by Adrian Montague and comprises four of the executive directors, the Company's Railway Estates Director and, selected for their expertise in property matters, three external non-executives and a special advisor. The Committee's role is to direct the Company's strategic development of its property portfolio and it met for the first time following the end of the 2002/03 financial year.

The **Executive Committee** is chaired by the Chief Executive and comprises all the executive directors and a number of senior executives. This Committee manages the functions of the business and implements the operational and financial objectives as set by the Board.

The roles of the Chairman, the Chief Executive and the Board and its governance arrangements will be reviewed annually and the performance of the members of the Board will be regularly assessed.

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

The following table identifies the number of Board and main committee meetings held between 3 October 2002 and 31 March 2003 and the attendance record of individual directors:

	Board Meetings	Nominations Committee	Remuneration Committee	Audit Committee	Safety Health & Environment Committee	Executive Committee
No. of Meetings held ^{(1) (2)}	6	1	6	2	1	5
Director						
J Armit	6	n/a	Attendee	n/a	1	5
D Bailey	6	1	6	2	1	n/a
J Cornell	6	1	6	n/a	1	n/a
I Coucher	6	n/a	n/a	n/a	n/a	4
P Henderson	6	n/a	n/a	n/a	n/a	5
R Henderson	6	n/a	n/a	Attendee	n/a	4
C Hoppe	6	n/a	6	n/a	1	n/a
C Leah	6	n/a	n/a	n/a	Attendee	4
I McAllister	6	1	6	n/a	n/a	n/a
A Montague	5	n/a	5	1	n/a	n/a
R Sayers	5	n/a	4	2	1	n/a
R Smith	6	n/a	6	2	n/a	n/a

1. Between 3 October 2002 and 31 March 2003.

2. Network Rail Property Board held its first meeting after 31 March 2003

Information about the directors' remuneration is given in the Directors' Remuneration Report on pages 22 to 36 of this Report and details of how the Board reviews financial and operational controls and risk management generally are shown on pages 40 and 41 and in the financial review on pages 11 to 15.

Relations with Members and Stakeholders

During the 2002/03 financial year two extraordinary general meetings for members of the Company's ultimate parent company Network Rail Limited were held, in August and December 2002, at which the members appointed at those dates ratified the appointment of the directors of the Board of Network Rail Limited (who are the same directors as those of the Company). At those meetings members were advised of developments within the Company. The Company also provided presentations on certain aspects of the business to assist members in their understanding.

The Annual General Meeting will be held in July 2003. In addition, other meetings and visits for Network Rail Limited's members are being arranged for 2003, to give members opportunities to learn more of the operational aspects of the business. Members also receive periodic newsletters and press releases and other information relating to the Company.

The Chief Executive and the Deputy Chief Executive as well as the other executive directors, have regular meetings with representatives of the Strategic Rail Authority, Office of the Rail Regulator, train operators, freight operators and other rail stakeholders.

Compliance with the Code

Save as indicated in this report the directors believe that where practical having regard to its corporate structure, the Company has implemented compliance with the Code (and the recommendations of Higgs and Smith Reports) following its acquisition by Network Rail Limited in October 2002 and that since that time it has complied with the current Code provisions where the requirements are of a continuing nature.

Going concern

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

Internal control

The Board is responsible for the Company's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. It can only provide reasonable, and not absolute, assurance against material misstatement or loss.

The Company is committed to the development and enhancement of existing systems of internal control and risk management.

The Company has established an Audit Committee, which consists of four non-executive directors. The Committee's terms of reference embrace the recommendations of the Smith Report, including the specific obligation to review and report on the effectiveness of the Company's internal control and risk management systems. The Audit Committee will monitor all forms of risk, except those covered by the terms of reference of the Safety, Health and Environment Committee.

Since its acquisition by Network Rail Limited on 3 October 2002, the Company has been required by the ORR to comply with the Turnbull Guidance on internal control and the new Board has taken progressive steps to establish an on-going process for the identification, evaluation and management of the key strategic risks including:

- Agreement of a Company risk management policy together with a strategy for delivery.
- Development of processes and systems to support the policy and strategy.
- Identification and agreement of the key risks faced by Network Rail in meeting its future business objectives and the allocation of director champions to develop management plans for the mitigation of key risks
- Agreement of an audit process to ensure regular review and reporting by Internal Audit to the Audit Committee in respect of the risk management system and the effectiveness of the internal controls implemented by management to mitigate the significant risks.

Steps are also being taken to embed risk management procedures into all the Company's operations and to extend awareness of the importance of the management of risks. Directors and Heads of Department will have responsibility for implementing risk management within their functions and for upholding the values expressed in the risk management policy.

The Directors have reviewed the system of internal control. The Board, as a result, concluded that there was a need for improvement in the existing internal control framework, and particularly the compliance therewith, and has put in place a number of key action plans to improve controls. In addition to the action plan which will deliver an integrated risk management system, the strengthening of the internal control framework is supported by a number of other Network Rail action plans, particularly those dealing with organisation and culture, financial control and Information Management.

Statement of Directors' Responsibilities

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

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for the system of internal control, for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent Auditors' Report

to the Members of Network Rail Infrastructure Limited (formerly Railtrack plc)

We have audited the financial statements of Network Rail Infrastructure Limited for the year ended 31 March 2003 which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the balance sheets, the consolidated cash flow statement and the related notes 1 to 32. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the directors' remuneration report that is described as having been audited.

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

Respective responsibilities of directors and auditors

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

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

The directors have also asked us to review whether the corporate governance statement reflects the Company's compliance with the seven provisions of the Combined Code specified for our review as if the Listing Rules of the Financial Services Authority applied, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

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

Basis of audit opinion

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

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

Fundamental uncertainty

In forming our opinion, we have considered the adequacy of the disclosures made in Note 1 to the financial statements, concerning a fundamental uncertainty relating to the West Coast Route Modernisation project ("WCRM"). During the year the Company has been seeking an agreement with Virgin Trains Limited ("Virgin"), the Strategic Rail Authority ("SRA") and the Office of the Rail Regulator ("ORR") on a revised contract and output specification in respect of WCRM. At the date of approval of the financial statements the SRA has concluded its review of the optimal capacity utilisation of the West Coast Mainline and the infrastructure necessary to support this capacity, and published its West Coast strategy for consultation. However the ORR has still to review the SRA's proposals and consent to them.

There is a fundamental uncertainty as to the outcome of the ORR's review and it is therefore not possible to quantify with any certainty the potential costs of any settlement with Virgin or the extent to which they would need to be provided in the consolidated profit and loss account, consolidated balance sheet or Company balance sheet at 31 March 2003.

Our opinion is not qualified in this respect.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 March 2003 and of the loss of the Group for the year then ended; and
- the financial statements and the part of the directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985.



Deloitte & Touche
Chartered Accountants and Registered Auditors, London
4 June 2003

Consolidated Profit and Loss Account

		2003 Before exceptional items	2003 Exceptional items (notes 5 & 8)	2003 Total	2002 Before exceptional items (restated) (see note 1)	2002 Exceptional items (notes 5 & 8) (restated) (see note 1)	2002 Total (restated) (see note 1)
	Note	£m	£m	£m	£m	£m	£m
Turnover	2	2,965	-	2,965	2,912	-	2,912
Operating costs	4	(2,862)	(23)	(2,885)	(2,371)	(20)	(2,391)
Operating profit	5	103	(23)	80	541	(20)	521
Profit on sale of properties		45	-	45	92	-	92
Net interest payable	8	(309)	(106)	(415)	(200)	(118)	(318)
(Loss)/ profit on ordinary activities before taxation		(161)	(129)	(290)	433	(138)	295
Tax credit/ (charge) on (loss)/ profit on ordinary activities	9	3	32	35	(150)	39	(111)
(Loss)/ profit on ordinary activities after taxation and retained (loss)/ profit for the year	24	(158)	(97)	(255)	283	(99)	184

All amounts relate to continuing activities.

Consolidated Statement of Total Recognised Gains and Losses

	Note	2003	2002 (restated) (see note 1)
		£m	£m
(Loss)/ profit for the financial year		(255)	184
Revaluation of the railway network	11	935	(47)
Revaluation of investment properties		-	1
Total recognised gains and losses for the year		680	138
Prior period adjustment (note 1)		(199)	
Total gains and losses recognised since last annual report		481	

Historical cost profits and losses are disclosed in note 25 to the financial statements.

Balance Sheets

	Note	2003 Group £m	2002 Group (restated) (see note 1) £m	2003 Company £m	2002 Company (restated) (see note 1) £m
Fixed assets					
Intangible fixed assets	10	25	-	-	-
Tangible fixed assets	11	12,835	9,219	12,819	9,219
Investments	12	-	-	49	11
		12,860	9,219	12,868	9,230
Current assets					
Stocks	13	38	48	38	48
Debtors: amounts falling due within one year	14	1,693	1,120	1,883	1,130
Debtors: amounts falling due after more than one year	14	31	115	31	98
		1,724	1,235	1,914	1,228
Current asset investments	15	178	218	56	192
Cash at bank and in hand		8	20	8	15
		1,948	1,521	2,016	1,483
Creditors: amounts falling due within one year	16	(10,274)	(5,485)	(10,350)	(5,458)
Net current liabilities		(8,326)	(3,964)	(8,334)	(3,975)
TOTAL ASSETS LESS CURRENT LIABILITIES		4,534	5,255	4,534	5,255
Creditors: amounts falling due after more than one year					
Convertible debt	17	-	(393)	-	(393)
Other creditors	18	(2,133)	(3,204)	(2,133)	(3,204)
		(2,133)	(3,597)	(2,133)	(3,597)
Provisions for liabilities and charges	20	(653)	(675)	(653)	(675)
Net assets		1,748	983	1,748	983
Capital and reserves					
Called up share capital	22	160	160	160	160
Revaluation reserve	23	1,339	406	1,339	406
Share premium reserve	23	85	-	85	-
Other reserves	23	1,209	1,209	1,209	1,209
Profit and loss account	23	(1,045)	(792)	(1,045)	(792)
Shareholders' funds		1,748	983	1,748	983
Attributable to equity shareholders		1,588	823	1,588	823
Attributable to non-equity shareholders		160	160	160	160

These financial statements were approved by the Board of Directors on 4 June 2003.

Signed on behalf of the Board of Directors:

John Armitt (Director)

Ron Henderson (Director)

Consolidated Cash Flow Statement

	Note	2003 £m	2002 £m
Net cash inflow from operating activities	28	192	498
Returns on investments and servicing of finance			
Interest received		15	26
Interest paid		(422)	(381)
Net cash outflow from returns on investments and servicing of finance		(407)	(355)
Capital expenditure			
Purchase of tangible fixed assets		(3,043)	(2,768)
Sale of tangible fixed assets		47	92
Capital element of finance lease receipts		7	8
Capital grants received		55	44
Net cash outflow from capital expenditure		(2,934)	(2,624)
Equity dividends paid		-	(88)
Acquisitions and disposals			
Purchase of subsidiaries		(38)	(3)
		(3,187)	(2,572)
Management of liquid resources			
Sale/ (purchase) of short term investments		40	(141)
Financing			
Issue of ordinary share capital		85	-
New loans		8,139	4,052
Capital element of finance leases repaid		(3)	(3)
Repayment of loans		(5,086)	(1,316)
Net cash inflow from financing		3,135	2,733
(Decrease)/ increase in cash in the year	29 & 30	(12)	20

Notes to the Financial Statements

Year Ended 31 March 2003

I. Basis of Preparation and Accounting Policies

Fundamental uncertainty – West Coast Route Modernisation (“WCRM”)

In preparing the financial statements the directors have considered a fundamental uncertainty relating to WCRM. During the year the Company continued to seek an agreement with Virgin Trains Limited (“Virgin”), the Strategic Rail Authority (“SRA”) and the Office of the Rail Regulator (“ORR”) on a revised contract and output specification in respect of WCRM. At the date of approval of the financial statements, the SRA has concluded its review of the optimal capacity utilisation of the West Coast Mainline and the infrastructure necessary to support this capacity, and published its West Coast strategy for consultation. However the ORR has still to review the SRA’s proposals and consent to them.

There is a fundamental uncertainty as to the outcome of the ORR’s review and it is not possible to quantify with any certainty the potential costs of any settlement with Virgin, or the extent to which they would need to be provided in the consolidated profit and loss account, consolidated balance sheet or Company balance sheet at 31 March 2003. In the opinion of the directors it would be seriously prejudicial for the Group to attempt to disclose any further information about the uncertainties or the potential financial effect of possible outcomes.

Principal accounting policies

The financial statements have been prepared in accordance with applicable United Kingdom accounting standards. The principal accounting policies adopted are described below.

Accounting convention and basis of consolidation

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

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

Changes in accounting policies

There have been the following changes to the Company’s accounting policies during the year. All other policies are consistent with those disclosed in the financial statements for the year ended 31 March 2002.

Fixed assets – The railway network

During the year, following extensive consideration, the Directors have determined that it is more appropriate to value the railway network at its depreciated replacement cost ("DRC"), make provision for impairment as necessary down to its value in use and depreciate it on a straight line basis over its estimated remaining weighted average useful economic life. A revaluation of the railway network and a re-estimation of its estimated remaining weighted average useful economic life will be performed annually with external verification of the valuation and asset life carried out, where required, at least every five years.

Under the previous accounting policy network fixed assets which comprise the railway network were included in the financial statements at historic cost with signalling, electrification and plant and machinery depreciated on a straight line basis and track, route structures, stations and depots depreciated using renewals accounting. Under renewals accounting the annual charge from the Company's asset maintenance plan was treated as the depreciation charge for the year for those assets with actual expenditure being capitalised as incurred.

In considering the appropriateness of a change in accounting policy and taking into account the Rail Regulator's statement on the proposed acquisition of Railtrack PLC by Network Rail of 27 June 2002 the Directors noted that DRC better reflected the economic value of the railway network and ensured that both the book value of fixed assets and the depreciation charge were accounted for on a consistent current cost basis.

In his statement the Regulator indicated that he proposes to make certain adjustments to the regulatory asset base ("RAB") to reflect the additional expenditure on operating, maintaining and renewing the network in the two years ended 31 March 2003. Given that the RAB represents the value in use of the railway network (being, in effect, a discounted future cashflow calculation) the directors consider that it gives a much clearer and more accurate economic assessment of the value to the business of the network as an asset. This clarity is particularly vital at a time when the RAB has increased significantly in a short period of time and is likely to continue to do so in the near future, a profile which could not be properly reflected under the previous accounting policy.

Whilst the change in policy produces a significant change in the annual depreciation charge, the revised policy is considered substantially more appropriate for the Company's current circumstances. The directors are also mindful of proposed amendments to UK accounting standards to make them consistent with international accounting standards, which will not permit renewals accounting.

In addition it brings the valuation of fixed assets in the statutory accounts much closer in line with the valuation in the Company's regulatory financial statements. For the year ended 31 March 2003 both sets of accounts will report a comparable fixed asset valuation.

The change in accounting policy for the railway network has decreased depreciation and other amounts written off fixed assets for the year ended 31 March 2003 from £1,889million to £438million. It has decreased the tax credit on loss on ordinary activities for the year from £399million to £35million on an undiscounted basis.

The change in accounting policy has resulted in a restatement of the comparative financial information for the year ended 31 March 2002, and opening shareholders' funds at 1 April 2002.

The effect of the change in accounting policy for the railway network is to improve the result in the consolidated profit and loss account for the year ended 31 March 2002 by £1,053million. This improvement comprised a reduction in depreciation of £1,599million and an increase in profit on sale of properties of £39million offset by an increase in tax on profit on ordinary activities of £585million.

The change in accounting policy for the railway network resulted in an increase in opening shareholders' funds at 1 April 2002 of £192million.

Deferred taxation

Following the acquisition by Network Rail and the introduction of the new accounting policy for network fixed assets, the directors considered the deferred taxation policy of the Group and concluded that it was more appropriate to present deferred taxation on an undiscounted basis. In forming this decision the directors were mindful of proposed amendments to UK accounting standards to make them consistent with international accounting standards, which will not permit discounting of deferred taxation.

The change in accounting policy for deferred taxation has decreased tax on profit on ordinary activities for the year ended 31 March 2003 by £263million.

The change in accounting policy has resulted in a restatement of the comparative financial information for the year ended 31 March 2002, and opening profit and loss reserves at 1 April 2002.

The effect of the change in accounting policy for deferred taxation is to reduce tax on profit on ordinary activities by £200million in the consolidated profit and loss account for the year ended 31 March 2002.

The change in accounting policy for deferred taxation resulted in a decrease in opening shareholders' funds at 1 April 2002 of £391million.

The combined effect of the above two changes in accounting policy is to improve the result in the consolidated profit and loss account for the year ended 31 March 2002 by £1,253million and reduce opening shareholders' funds at 1 April 2002 by £199million.

Turnover

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

Performance regimes

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

Tangible Fixed assets

Investment properties

Investment properties comprise offices and other non-specialist properties that are not occupied by the Company where the interest is completely separable from the railway infrastructure, and which are held for their investment potential. Investment properties are revalued periodically in accordance with SSAP 19 'Accounting for Investment Properties'. Any surplus or deficit on revaluation is transferred to the revaluation reserve unless a deficit below original cost, or its reversal, on an individual investment property is expected to be permanent, in which case it is recognised in the profit and loss account for the year.

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

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

Fixed assets – The railway network

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

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

Depreciation

The railway network is depreciated on a straight line basis over its estimated remaining weighted average useful economic life.

The estimated remaining weighted average useful economic life of the network is currently 25 years.

Intangible fixed assets

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

Fixed asset investments

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

Grants

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

Deferred taxation

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

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

Long term contracts

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

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

Stocks

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

Current asset investments

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

Leases

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

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

Pension costs

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

Research and development

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

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

Financial instruments

The Company uses various derivative products, principally interest rate swaps and forward rate agreements, to manage its exposure to interest rate fluctuations on its debt portfolio. Amounts payable or receivable in respect of these transactions are recognised as adjustments to interest expense over the period of the contracts. Termination payments made or received in respect of derivatives are spread over the life of the underlying exposure in cases where the underlying exposure continues to exist. In other cases any termination payments are taken to the profit and loss account. No transactions of a speculative or trading nature are undertaken. Financial instruments are not recognised in the balance sheet.

Capitalised interest

Interest is capitalised during the period of construction on all projects to the extent that the project is not financed by the contractor. The average rate used during the year was 4.67% (2001/02: 5.62%).

Foreign exchange

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

Eurobonds and exchangeable bonds

The discount of principal and related fees associated with the issue of eurobonds and exchangeable bonds are accounted for as a reduction in the balance outstanding of the eurobonds and exchangeable bonds, and are amortised over the lives of the bonds. The amortisation charge is included within interest payable.

Property clawback

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

2. Turnover

	2003 £m	2002 £m
Passenger franchise revenue	1,666	1,633
SRA revenue grants	996	980
Freight revenue	83	86
Property rental income	159	153
Other income	61	60
	2,965	2,912

All turnover relates to the UK.

All (losses)/ profits arose from the Group's principal activity, the management of the national rail infrastructure.

3. Performance Regimes

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

	2003 £m	2002 £m
Included in turnover		
Access charge supplements	47	20
Net penalty payable to customers	(442)	(376)
	(395)	(356)

4. Operating costs

	2003 Before exceptional items £ m	2003 Exceptional items (see note 5) £ m	2003 Total £ m	2002 Before exceptional items (restated) (see note 1) £ m	2002 Exceptional items (see note 5) (restated) (see note 1) £ m	2002 Total (restated) (see note 1) £ m
Other operating income	(99)	-	(99)	(94)	-	(94)
Staff costs (note 6)	561	-	561	468	-	468
Own work capitalised	(282)	-	(282)	(196)	-	(196)
Capital grants amortised	(13)	-	(13)	(11)	-	(11)
Other external charges	2,257	23	2,280	1,888	20	1,908
Depreciation and other amounts written off tangible fixed assets	438	-	438	316	-	316
	2,862	23	2,885	2,371	20	2,391

5. Operating profit

	2003	2002 (restated) (see note 1)
	£m	£m
Operating profit is stated after charging:		
Rentals under operating leases		
Plant and machinery	5	4
Other	68	63
Research and development	8	3
Depreciation and other amounts written off tangible fixed assets	438	316
Amortisation of intangible fixed assets	1	-
Auditors' remuneration		
Statutory audit services	0.4	0.4
Other compliance work	0.2	0.1
Assistance with confidential SRA negotiations	-	0.1
Other information systems advisory work	-	0.3
Other non-audit fees	0.3	0.6
Exceptional items		
Fees and costs payable to administrators	23	20

6. Employees

	2003	2002
	£m	£m
Staff costs during the year (including directors):		
Wages and salaries	449	376
Social security costs	35	30
Pension costs	77	62
	561	468
Average number of persons employed:	No.	No.
Management and operation of railway	13,240	12,407
Number of persons employed:	No.	No.
At 31 March 2003	13,774	12,610

Included within the total staff cost above is the remuneration of the directors totalling £4.1 million (2001/02: £3.5million) details of which can be found within the Remuneration Report on pages 22 to 36.

7. Pension costs

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

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

A full actuarial valuation of the Network Rail Section was carried out by the scheme actuary at 31 December 2001 and adjusted to 31 March 2002 and 31 March 2003 by the Group's pension advisor, a qualified independent actuary. The total contribution rate payable under the RPS is normally split in the proportion 60:40 between the Group and the members. At the start of the year, the Group and members were paying contributions of 7.5% and 5.0% of Section Pay respectively. With effect from 1 January 2003 the rates changed to 14.25% and 6.5% respectively and this is due to change to 14.25% and 9.5% respectively over 2 years. These rates were determined following the funding valuation carried out by the Scheme Actuary as at 31 December 2001. If a surplus or deficit arises, the provisions in the RPS Rules mean that the Company and members usually benefit from or pay for this respectively in the proportion 60:40.

Based on the adjusted valuation, the Group's pension charge for the year ended 31 March 2003 was £77million (2001/02: £62million). The pension provision as at 31 March 2003 is £41million (2002: prepayment of £10million).

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

The principal assumptions used in establishing the pension cost for the year were inflation of 2.60% per annum, an investment return of 5.40% per annum, and pay inflation of 5.10% per annum. Assets have been taken at market value. Liabilities and the contribution rate have been assessed using the projected unit credit method. The Network Rail Section's funding level was assessed on this basis to be 66% of its liabilities as at 31 March 2002.

FRS17 pension disclosures

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

The Group operates a tax exempt, approved defined benefit scheme in the UK and has some unapproved arrangements for a small number of executives. The RPS operates on a "shared cost" basis. Broadly speaking, the costs of pension benefits are borne by the Company and members in the proportion 60:40. A full actuarial valuation of the approved scheme was carried out at 31 December 2001 and adjusted to 31 March 2002 and 31 March 2003 for FRS 17 disclosure purposes by a qualified independent actuary. The major assumptions used by the actuary were (in nominal terms):

	At 31 March 2003	At 31 March 2002
Real rate of increase in salaries	5.10% p.a.	5.25% p.a.
Rate of increase to pensions in payment	2.60% p.a.	2.75% p.a.
Discount rate	5.40% p.a.	6.00% p.a.
Inflation assumption	2.60% p.a.	2.75% p.a.

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

	Long-term rate of return expected at 31 March 2003 %	Value at 31 March 2003 £m	Long-term rate of return expected at 31 March 2002 %	Value at 31 March 2002 £m
Equities	6.12%	759	6.92%	892
Bonds	4.12%	103	4.92%	238
Property	6.12%	75	6.92%	60
Total market value of assets		937		1,190
Present value of scheme liabilities		(1,233)		(1,272)
Deficit		(296)		(82)
Related deferred tax asset		89		24
Net pension liability		(207)		(58)

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

	Value at 31 March 2003	Value at 31 March 2002 (restated) (note 1)
	£m	£m
Net assets excluding SSAP24 pension liability/ asset	1,789	973
Net FRS17 pension liability	(207)	(58)
Net assets including FRS 17 pension liability	1,582	915
Profit and loss reserve excluding SSAP 24 pension liability/ asset	(1,004)	(802)
Net FRS17 pension liability	(207)	(58)
Profit and loss reserve including FRS17 pension liability	(1,211)	(860)

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

	2003 £m
Current service cost	45
Past service cost	-
Total charge to operating profit	45
Expected return on pension scheme assets	78
Interest on pension scheme liabilities	(78)
Return credited to net finance income	-

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

	2003 £m
Actual return less expected return on assets	(360)
Experience gains and losses on liabilities	-
Changes in assumptions	(26)
Expected employee contribution towards shared cost of deficit	197
Actuarial loss	(189)
Movement in deficit in the year	
Deficit in scheme at beginning of the year	(82)
Current service cost	(45)
Contributions	26
Net return on assets	-
Actuarial loss	(189)
Adjustment due to shared nature cost	(6)
Deficit in scheme at end of the year	(296)

History of experience gains and losses:

	2003 £m
Difference between expected and actual return on scheme assets	(360)
Percentage of scheme assets	38.4%
Experience gains and losses	-
Percentage of scheme liabilities	0%
Total amount recognised in the statement of total recognised gains and losses	(189)
Percentage of scheme liabilities	15.3%

8. Net interest payable

	2003	2002
	£m	£m
Interest payable and similar charges:		
On bank loans and overdrafts	177	160
Interest paid on loan from immediate parent company	163	-
On other loans	48	133
Exceptional interest payments on early termination of debt	106	-
Exceptional future hedges termination payments	-	118
Total	494	411
Interest capitalised	(63)	(67)
	431	344
Interest receivable	(16)	(26)
Net interest payable	415	318

9. Tax credit/ (charge) on (loss)/ profit on ordinary activities

	2003	2002
	£m	(restated) (see note 1) £m
Analysis of credit/ (charge) in year		
Current UK Corporation Tax at 30%:		
Over provision in respect of prior years	6	28
Advance Corporation Tax written off	-	(8)
Total current tax credit	6	20
Deferred tax at 30%:		
Credit for timing differences arising in the year	29	(131)
Total deferred tax	29	(131)
Tax credit/ (charge) on (loss)/ profit on ordinary activities	35	(111)

Current factors affecting the tax credit/ (charge) for the year

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

	2003	2002
	£m	(restated) £m
(Loss)/ profit on ordinary activities before tax	(290)	295
(Loss)/ profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30% (2001/2002: 30%)	(87)	88
Accelerated capital allowances	(171)	13
Tax losses carried forward	189	(162)
Provisions	(2)	4
Adjustments in respect of prior years	(6)	(28)
Advance Corporation Tax written off	-	8
Permanent differences	58	43
Pension adjustment	13	14
Total current tax credit	(6)	(20)

10. Intangible fixed assets

	Concessions
	£m
Cost	
At 1 April 2002	-
Additions	26
At 31 March 2003	26
Accumulated amortisation	
At 1 April 2002	-
Charge for the year	(1)
At 31 March 2003	(1)
Net book value	
At 1 April 2002	-
At 31 March 2003	25

On 6 November 2002 Network Rail (CTRL) Limited, a wholly owned subsidiary of the Company acquired the St Pancras Concession Agreement and Railway Services Agreement ("RSA") for consideration of £26million.

The St Pancras Concession Agreement lasts until 29 July 2086 and is not currently being amortised because the concession has not commenced. Under the RSA services are provided up to completion and opening of section 2 of the Channel Tunnel Rail Link planned for late 2006. The RSA is being amortised over the period to the end of 2006.

11. Tangible fixed assets: Group

	At 1 April 2002 (restated) (see note 1) £m	Additions £m	Disposals £m	Depreciation charge for the year £m	Revaluation during year £m	At 31 March 2003 £m
The railway network at valuation	9,146	3,121	-	(438)	935	12,764
Investment properties at valuation	73	-	(2)	-	-	71
Total	9,219	3,121	(2)	(438)	935	12,835

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

Following the change in accounting policy in respect of the valuation of the railway network (see note 1), the depreciation charge for any year is calculated using the average fixed asset net book value for the year and the estimated remaining weighted average useful economic life of the railway network. The estimated remaining weighted average useful economic life of the network is currently 25 years.

The depreciated replacement cost of the railway network exceeds its value in use and has therefore been impaired down to its value in use (which is primarily comprised of the discounted future cash flows expected to arise from the regulatory asset base).

The revaluation in the current year represents an increase in the railway network value in use, as a result of the Regulator allowing certain adjustments to the regulatory asset base to reflect the additional expenditure on operating, maintaining and renewing the network in the two years ended 31 March 2003.

As at 31 March 2003, the comparable amount of the railway network according to the historic cost convention is determined as £10,096million (31 March 2002: £8,800million).

The book value of the railway network in the Group financial statements includes £16million of railway arches held by the Company's wholly owned subsidiary Network Rail (Spacia) Limited.

The freehold, heritable, feuhold and long leasehold investment properties were valued as at 31 March 2003 at £71million (31 March 2002: £73million). The valuations were undertaken on the basis of open market value in accordance with the appraisal and valuation manual of the Royal Institution of Chartered Surveyors. External valuers, CB Hillier Parker, valued 13 of the 75 investment properties (representing 84% by value of the portfolio). The remaining properties were valued by the Director of Sales, Railway Estates, a chartered surveyor.

As at 31 March 2003, the comparable amount of the investment properties according to the historical cost convention is determined as £13million (31 March 2002: £13million).

12. Investments: Company

	At cost £m
Investments in subsidiaries at 1 April 2002	11
Additions during the year	38
Investment in subsidiaries at 31 March 2003	49

On 2 April 2002 the Company purchased a further 8 million ordinary shares in its 100% subsidiary Network Rail Insurance Limited (formerly Railtrack Insurance Limited) for consideration of £8million.

On 14 May 2002 the Company purchased a further 5 million ordinary shares and 1000 redeemable preference shares in Network Rail Insurance Limited (formerly Railtrack Insurance Limited) for consideration of £5million and £22million respectively.

On 19 August 2002 the Company acquired Network Rail (Spacia) Limited (formerly Railtrack (Spacia) Limited) for consideration of £3million. The net assets acquired and their provisional fair values were:

	Book value £m	Fair value £m
Fixed assets	15	16
Other assets	2	2
Current liabilities	(14)	(14)
Long term liabilities	(1)	(1)
Net assets	2	3
Consideration:		
Cash		17
Loans repaid		(14)
		3

No goodwill arose on the transaction.

The Company's subsidiaries (all directly owned) are set out below:

	Country of incorporation	Proportion of all classes of issued share capital owned by the Company	Principal activity
Network Rail Insurance Limited (formerly Railtrack Insurance Limited)	Guernsey	100%	Insurance
Network Rail (CTRL) Limited (formerly Hackremco (No.1958) Limited)	England	100%	Holds St Pancras concession and CTRL Railway Services Agreement
Network Rail (Spacia) Limited (formerly Railtrack (Spacia) Limited)	England	100%	Property letting
Network Rail (Stations) Limited (formerly Railtrack (Stations) Limited)	England	100%	Dormant
Network Rail (Projects) Limited (formerly Railtrack (Projects) Limited)	England	100%	Dormant
Network Rail (Property) Limited (formerly Cambridge Gate Limited)	England	100%	Dormant
Spacia (2002) Limited	England	100%	Dormant

13. Stocks

	2003 Group and Company £m	2002 Group and Company £m
Raw materials and consumables	25	14
Properties in the course of development	1	14
Long term contract balances:		
Net cost	18	26
Applicable payments on account	(6)	(6)
	38	48

I4. Debtors

	2003 Group £m	2002 Group £m	2003 Company £m	2002 Company £m
Amounts falling due within one year				
Trade debtors	285	291	285	291
Capital grants receivable	1	3	1	3
Other debtors	191	269	381	279
Prepayments and accrued income	1,209	550	1,209	550
Net investment in finance leases	7	7	7	7
	1,693	1,120	1,883	1,130
Amounts falling due after more than one year				
Other debtors	-	18	-	1
Prepayments and accrued income	-	59	-	59
Net investment in finance leases	31	38	31	38
	31	115	31	98
Total	1,724	1,235	1,914	1,228
Net investment in finance leases comprises:				
Total lease payments receivable	54	64	54	64
Less: finance charges allocated to future periods	(16)	(19)	(16)	(19)
	38	45	38	45

Aggregate rentals receivable in respect of finance leases for the Group and Company were £11 million (2001/02: £12million).

I5. Current asset investments

	2003 Group £m	2002 Group £m	2003 Company £m	2002 Company £m
Short term money market deposits	178	218	56	192

16. Creditors: Amounts falling due within one year

	2003	2002	2003	2002
	Group	Group	Company	Company
	£m	£m	£m	£m
Bank loans and overdrafts (see note 19)	11	3,158	11	3,158
Loan from immediate parent company (see note 19)	8,139	-	8,139	-
Commercial paper	-	49	-	49
Finance leases and hire purchase contracts	-	1	-	1
Finance creditor owed to Railtrack Group PLC and its subsidiaries	-	349	-	349
Payments received on account	24	32	24	32
Trade creditors	687	623	687	623
Amounts owed to other group companies	11	-	11	-
Other amounts owed to Railtrack Group PLC and its subsidiaries	-	2	-	2
Taxation and social security	-	36	-	36
Other creditors	48	159	124	132
Capital grants deferred income	10	10	10	10
Interest due on loan to immediate parent company	110	-	110	-
Other interest accruals	27	67	27	67
Other accruals and deferred income	1,207	999	1,207	999
	10,274	5,485	10,350	5,458

Amounts drawn down under the £4.4billion Government guaranteed facility and the £1 billion revolving credit facility existing at 31 March 2002 were repaid on 3 October 2002 along with the £349million owed to Railtrack Group PLC and its subsidiaries.

In each case the £9billion credit facility secured by the Company's immediate parent company, Network Rail Holdco Limited was used to fund the repayment. Amounts owed to Network Rail Holdco Limited are disclosed above as a loan from immediate parent company.

The above £9billion facility comprises a 364 day term loan facility of £6.85billion and a 364 day revolving credit facility of £2.15billion. The term loan is divided into three tranches:

Tranche A is for the purpose of funding the acquisition of the entire issued share capital of the Company by Network Rail Holdco Limited. Tranche B is for the subscription of shares in the Company to allow it to make payments in respect of premia payable in connection with the redemption of bonds issued in the capital markets. Tranche C is for the purpose of refinancing the indebtedness of the Company and its subsidiaries, funding the acquisition of the right to operate the St Pancras Concession and funding of the acquisition of the operational, management and maintenance services in respect of the Channel Tunnel Rail Link project. The revolving credit facility is for the working capital purposes of the Group and to finance payments of interest due on the facility.

Amounts under Tranche C and the revolving credit facility are forwarded to the Group from Network Rail Holdco Limited in accordance with an intercompany loan agreement that mirrors the £9billion bridge finance facility detailed above.

17. Convertible debt: Amounts falling due after more than one year

	2003 Group and Company £m	2002 Group and Company £m
3.5% exchangeable bonds due 2009 (less unamortised discount and fees of £nil (31 March 2002: £7million))	-	393

The 3.5% exchangeable bonds were redeemed on 10 October 2002, the unamortised discount and fees were written off and are included in exceptional interest expense (see note 8).

18. Other creditors: Amounts falling due after more than one year

	2003 Group and Company £m	2002 Group and Company £m
Bank loans	1,399	1,410
Eurobonds	-	1,123
West Yorkshire PTE due 2019	-	5
Finance leases and hire purchase contracts	41	41
Debt issued under Euro Medium Term Note programme	-	8
Capital grants deferred income	596	556
SRA deferred development income	84	-
Other accruals and deferred income	13	61
	2,133	3,204

The Eurobonds and Medium Term Note were repaid on 10 October 2002. Each class of bond or note was redeemed at the higher of par and the redemption value, calculated as a margin over the appropriate reference gilt. The unamortised discount and fees were written off and are included in exceptional interest expenses. The West Yorkshire PTE loan was repaid on 7 October 2002.

Analysis of bank loans and Eurobonds

	2003	2002
	Group and	Group and
	Company	Company
	£m	£m
Bank loans		
HSBC Bank due 2017 repayable by instalments	221	224
Barclays Bank due 2017 repayable by instalments	62	63
Royal Bank of Scotland due 2017 repayable by instalments	71	73
European Investment Bank due 2007	100	100
6.42% European Investment Bank due 2009	100	100
6.42% European Investment Bank due 2011	100	100
5.77% European Investment Bank due 2012	300	300
5.57% European Investment Bank due 2013	200	200
Kreditanstalt für Wiederaufbau due 2013	145	150
Kreditanstalt für Wiederaufbau due 2015	100	100
	1,399	1,410
Eurobonds		
9.125% eurobonds due 2006	-	135
5.875% eurobonds due 2009 (less unamortised discount and fees of nil (31 March 2002: £2million))	-	348
9.625% eurobonds due 2016	-	101
7.375% eurobonds due 2022 (less unamortised discount and fees of nil (31 March 2002: £4million))	-	296
5.875% eurobonds due 2028 (less unamortised discount and fees of nil (31 March 2002: £7million))	-	243
	-	1,123

The consent of bondholders and note holders to the early redemption of financial instruments detailed above was a condition precedent to Network Rail's acquisition of the Company.

19. Financial instruments

The Group's funding and treasury operations ("Treasury") are co-ordinated and managed in accordance with policies and procedures approved by the board. Treasury is subject to regular internal audits and does not engage in trades of a speculative nature. The market and legal limitations imposed as a result of the railway administration order have now been lifted.

Treasury has a board approved counterparty list which contains the entities with whom it may invest cash and transact derivative business. Limits are set with reference to published credit ratings. These limits dictate how much and for how long Treasury may deal with each counterparty.

The Group has a policy of immediately hedging all identified foreign exchange exposures over £250,000 or equivalent. Since the exit from administration, the Group has hedged its foreign exchange exposures in accordance with this policy.

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

	2003	2002
	Group	Group
	£m	£m
Due within one year		
Bank loans and overdrafts	11	3,158
Loan from parent company	8,139	-
Finance creditor owed to Railtrack Group PLC and its subsidiaries	-	349
Commercial paper	-	49
Finance leases and hire purchase contracts	-	1
	8,150	3,557
Due within one to two years		
Bank loans and overdrafts	22	11
Finance leases and hire purchase contracts	1	-
	23	11
Due within two to five years		
Bank loans and overdrafts	196	78
Eurobonds	-	135
West Yorkshire PTE due 2019	-	1
Finance leases and hire purchase contracts	2	2
	198	216
Due after five years		
Bank loans and overdrafts	1,181	1,321
Eurobonds	-	988
3.5% exchangeable bonds due 2009	-	393
Medium Term Note due 2009	-	8
West Yorkshire PTE due 2019	-	4
Finance leases and hire purchase contracts	38	39
	1,219	2,753
Total		
Bank loans and overdrafts	1,410	4,568
Loan from parent company	8,139	-
Finance creditor owed to Railtrack Group PLC and its subsidiaries	-	349
Commercial paper	-	49
Eurobonds	-	1,123
3.5% exchangeable bonds due 2009	-	393
Medium Term Note due 2009	-	8
West Yorkshire PTE due 2019	-	5
Finance leases and hire purchase contracts	41	42
	9,590	6,537

Interest rates on borrowings

The interest rate exposure on gross borrowings at 31 March 2003 and 2002 was:

	Floating borrowings	Fixed borrowings	Total	Fixed borrowings	
	£m	£m		Weighted average interest rate	Weighted average time for which rate is fixed
			£m	%	Years
2003	8,890	700	9,590	5.90	9.0
2002	4,321	2,216	6,537	6.08	12.2

All borrowings are denominated in sterling. The floating rate borrowings are all referenced to London Inter Bank Offered Rate (LIBOR). The decrease in the weighted average interest rate for fixed borrowings was due to a decrease in the drawn margin by the European Investment Bank of 15 basis points. This represents the reversal of the increase in the year ended 31 March 2002 on completion of conditions precedent to the amendment of the EIB facilities documentation, which included the discharge of the railway administration order.

Interest rates on other financial liabilities

The Group has £13million (31 March 2002: £61million) of long term non-interest bearing financial liabilities for which the weighted average period to maturity is 1.5 years (31 March 2002: 1.1 years).

Investment in financial assets

Interest bearing assets at 31 March 2003 and 2002 were:

	Floating rate investments	Fixed rate investments	Total	Fixed assets with fixed rates	
	£m	£m		Weighted average interest rate	Weighted average time for which rate is fixed
			£m	%	Years
2003	143	81	224	5.94	4.7
2002	217	66	283	7.28	4.6

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

Included in the above analysis are assets belonging to Network Rail Insurance Limited (formerly Railtrack Insurance Limited) of £121million (31 March 2002: £31million). Not included in the above analysis are monies held in escrow client accounts of £1million (31 March 2002: £3million).

The Group has no long term non-interest bearing financial assets (31 March 2002: £nil).

Committed facilities

At 31 March 2003 and 2002 the Group had the following undrawn committed facilities:

	2003 Drawn £m	2003 Undrawn £m	2003 Total £m	2002 Drawn £m	2002 Undrawn £m	2002 Total £m
£9billion bridge facility from immediate parent company	8,139	562	8,701	-	-	-
SRA support facility A	-	4,000	4,000	-	-	-
SRA support facility B	-	3,000	3,000	-	-	-
Bank bilateral facilities	-	-	-	2,132	2,268	4,400
	8,139	7,562	15,701	2,132	2,268	4,400

Undrawn committed borrowing facilities expire as follows:

	2003 £m	2002 £m
Within one year	562	2,268
Within one to two years	3,000	-
In more than two years	4,000	-
	7,562	2,268

Not included in the above analysis are the £800million European Investment Bank and £250million Kreditanstalt für Wiederaufbau facilities as these were fully drawn as at 31 March 2003 and 31 March 2002.

The £4.4billion Government guaranteed facility and the £1 billion revolving credit facility were repaid on 3 October 2002.

In addition to the facilities above, there are two support facilities provided by the SRA for £800million and £250million. The use of these facilities is limited to the repayments of the EIB and KfW facilities should this become necessary.

Uncommitted facilities

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

Fair value

A comparison of current and book values of all the Group's financial instruments at 31 March 2003 and 31 March 2002 is provided below. Where market prices are not available for a particular instrument, fair values have been calculated by discounting cash flows at prevailing interest rates.

	2003 Book value £m	2003 Fair value £m	2002 Book value £m	2002 Fair value £m
Assets/ (liabilities)				
Interest bearing financial assets	224	224	283	283
Debt securities and finance leases	(41)	(41)	(1,558)	(1,610)
Short term borrowings and current portion of long term debt	(8,150)	(8,150)	(3,556)	(3,556)
Long term borrowings	(1,399)	(1,443)	(1,423)	(1,453)
Long term non-interest bearing financial liabilities	(13)	(13)	(61)	(61)
Interest rate swaps and similar instruments	-	-	-	(1)
Forward foreign currency contracts	-	3	-	1

Gains and losses on hedges

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

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

	2003 Gains £m	2003 Losses £m	2003 Total net gains £m	2002 Gains £m	2002 Losses £m	2002 Total net gains/ (losses) £m
Unrecognised gains and losses on hedges at 1 April	1	(1)	-	23	(4)	19
Gains and losses arising in the prior year that were recognised in the current year	(1)	1	-	(23)	4	(19)
Gains and losses arising in the current year that were not recognised in the current year	3	-	3	1	(1)	-
Unrecognised gains and losses on hedges at 31 March	3	-	3	1	(1)	-
Of which:						
Gains and losses expected to be recognised within one year	2	-	2	1	(1)	-
Gains and losses expected to be recognised after more than one year	1	-	1	-	-	-

Currency analysis of net assets

All material net assets are in sterling.

Market and credit risk

The Group holds a mixture of fixed and floating rate debt. The Group is exposed to upward movements in interest rates because it has floating rate debt in excess of floating rate assets.

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

20. Provisions for liabilities and charges: Group and Company

	At 1 April 2002 (restated) (note 1) £m	Utilised in year £m	Provision raised £m	At 31 March 2003 £m
Deferred tax (note 21)	547	(29)	-	518
Pension	-	-	41	41
Environmental liabilities	43	(5)	-	38
Other	85	(33)	4	56
	675	(67)	45	653

At 31 March 2002 the Group balance sheet included a pension prepayment within debtors of £10million. See note 7 for further details of the Group's pension scheme.

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

21. Deferred taxation

As discussed in note 1, following the introduction of the new accounting policy for network fixed assets, the directors considered the effect on the deferred taxation position of the Group and concluded that it was more appropriate to present deferred taxation on an undiscounted basis. In forming this decision the directors were mindful of the transition to International Accounting Standards in the near future where discounting of deferred taxation will no longer be permissible.

	£m
At 1 April 2002 (as previously stated)	2
Prior year adjustment as a result of change in accounting policy for network fixed assets	154
Prior year adjustment as a result of change in accounting policy for deferred taxation	391
At 1 April 2002 (as restated)	547
Deferred tax credited to the profit and loss account	(29)
At 31 March 2003	518

	2003	2002 (restated) (see note 1)
	£m	£m
Accelerated capital allowances	959	788
Short term timing differences	(49)	(38)
Tax losses carried forward	(392)	(203)
Undiscounted provision for deferred tax	518	547

If there had been no change in accounting policy for either railway network fixed assets or deferred taxation, the balance of deferred taxation at 31 March 2003 would be an asset of £128million.

The current rate of corporation tax of 30% (2001/02: 30%) has been used to calculate the amount of deferred taxation. Provision has been made for all deferred taxation assets and liabilities in respect of accelerated capital allowances, short term timing differences and tax losses carried forward, arising from transactions and events recognised in the financial statements of the current year and previous years.

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

	2003	2002 (restated) (see note 1)
	£m	£m
Rolled over gains	184	184
Revaluation of fixed assets	414	135
Deferred taxation provided at 30% (2001/02 – 30%)	598	319

The £184million (31 March 2002: £184million) of tax in respect of rolled over gains relates partly to the gains realised by the British Railways Board which have been deferred through the application of capital gains rollover relief into assets vested in Railtrack PLC (now Network Rail Infrastructure Limited).

There is insufficient historical information to calculate a provision for deferred taxation in respect of the revaluation of fixed assets. However the potential maximum provision would be £414million (31 March 2002 restated: £135million).

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

22. Called up share capital

	2003 Number of shares	2003 £m	2002 Number of shares	2002 £m
Authorised				
Ordinary shares of 0.1p each	500,050,200	-	50,000,000	-
Redeemable shares of £1 each	500,000,000	500	500,000,000	500
		500		500
Called up, allotted and fully paid				
Ordinary shares of 0.1p each	50,084,937	-	50,000,000	-
Redeemable shares of £1 each	160,000,000	160	160,000,000	160
		160		160

On 14 October 2002, 84,937 ordinary shares were allotted to Network Rail Holdco Limited, the Company's parent company for cash consideration of £84,937,000.

The Company has the option to repurchase any or all of the redeemable shares at any date after 31 March 2002. No premium is repayable on such redemption and the option to repurchase has no expiry date. The redeemable shareholders have no right to redemption at their instigation. Redeemable shares do not carry voting rights, or rank for dividend, but may do so if the Company passes a resolution to that effect. A condition of the sale of Railtrack PLC to Network Rail Limited was that Railtrack Group PLC would waive all rights to redemption of these shares once the transaction was completed.

23. Group and Company reserves

	Revaluation reserve £m	Share premium £m	Other reserves £m	Profit and loss account £m	Total £m
At 1 April 2002 (as previously reported)	60	-	1,209	(247)	1,022
Prior year adjustment as a result of change in accounting policy for the railway network	346	-	-	(154)	192
Prior year adjustment as a result of change in accounting policy for deferred taxation	-	-	-	(391)	(391)
At 1 April 2002 (as restated)	406	-	1,209	(792)	823
Revaluation of the railway network	935	-	-	-	935
Issue of share capital	-	85	-	-	85
Transfer of realised profits (net of corporation tax)	(2)	-	-	2	-
Retained loss	-	-	-	(255)	(255)
At 31 March 2003	1,339	85	1,209	(1,045)	1,588

The decrease in the profit and loss reserve as a result of the change in accounting policy for the railway network was due to provision of deferred taxation.

The loss for the Company for the year was identical to that of the Group.

The revaluation reserve includes £58million relating to investment properties.

24. Reconciliation of movement in shareholders' funds

	2003 £m	2002 (restated) (see note 1) £m
(Loss)/ profit for the year	(255)	184
Revaluation of the railway network	935	(47)
Revaluation of investment properties	-	1
New share capital subscribed	85	-
Net addition to shareholders' funds	765	138
Opening shareholders' funds (originally £1,182million before adjusting for a prior year adjustment of £199million)	983	845
Closing shareholders' funds	1,748	983

25. Historical cost profits and losses

	2003 £m	2002 (restated) £m
(Loss)/ profit on ordinary activities before taxation	(290)	295
Additional depreciation charge on an historical cost basis	(1,451)	(1,599)
Additional profit on sale of properties recognised under new accounting policy for the railway network	(7)	(39)
Realisation of property revaluation gains of previous years	2	2
Historical cost loss on ordinary activities before taxation	(1,746)	(1,341)
Historical cost loss for the year accumulated after taxation	(1,711)	(1,452)

26. Capital commitments

	2003 £m	2002 £m
Capital expenditure commitments contracted for (including the capital value of finance lease commitments) not provided for in these financial statements	1,873	2,034

27. Operating lease commitments

	2003 £m	2002 £m
Land and buildings		
Leases which expire:		
Within one year	2	2
Within two to five years	7	12
After five years	16	9
	25	23
Other		
Leases which expire:		
Within one year	40	37
Within two to five years	8	2
After five years	-	-
	48	39
Total		
Leases which expire:		
Within one year	42	39
Within two to five years	15	14
After five years	16	9
	73	62

28. Reconciliation of operating profit to net cash inflow from operating activities

	2003	2002 (restated) (see note 1)
	£m	£m
Operating profit	80	521
Depreciation and amortisation (net of capital grants amortised)	426	305
Decrease/ (increase) in stocks	10	(8)
Increase in debtors	(499)	(768)
Increase in creditors	168	375
Increase in provisions	7	73
Net cash inflow from operating activities	192	498

There was no cash outflow in respect of the exceptional operating item in the current or prior year.

29. Analysis of changes in net debt

	At 1 April 2002 £m	Cash flows £m	Amortisation of discount £m	New finance leases £m	At 31 March 2003 £m
Cash at bank and in hand	20	(12)	-	-	8
Borrowings due within one year	(3,557)	(4,593)	-	-	(8,150)
Borrowings due after one year	(2,980)	1,543	(1)	(2)	(1,440)
Current asset investments	218	(40)	-	-	178
	(6,299)	(3,102)	(1)	(2)	(9,404)

30. Reconciliation of net cash flow to movement in net debt

	2003 £m	2002 £m
(Decrease)/ increase in cash in the year	(12)	20
Cash inflow from increase in debt and lease financing	(3,050)	(2,733)
Cash (inflow)/ outflow from (decrease)/ increase in liquid resources	(40)	141
	(3,102)	(2,572)
Change in net debt resulting from cash flows		
Liquid resources acquired with subsidiaries	-	26
New finance leases	(2)	(7)
Amortisation of discount	(1)	(2)
Movement in net debt in the year	(3,105)	(2,555)
Net debt at 1 April	(6,299)	(3,744)
Net debt at 31 March	(9,404)	(6,299)

31. Ultimate parent company and controlling entity

On 3 October 2002, Network Rail Holdco Limited, a wholly owned subsidiary of Network Rail Limited, purchased the entire share capital of Railtrack PLC (now Network Rail Infrastructure Limited) from Railtrack Group PLC.

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

32. Related party transactions

During the period of administration to 3 October 2002 the Company provided various services to Railtrack Group PLC and its subsidiary companies, including accounting and analysis, technical consultancy and property services and sales. In addition on 19 August 2002 the Company purchased from Railtrack Group PLC the entire share capital of Network Rail (Spacia) Limited as disclosed in note 10. On 3 October 2002 Railtrack Group PLC ceased to be a related party.

Since 3 October 2002 the Company met the exemption requirements of FRS 8 'Related party transactions' in that 90% or more of its voting rights are controlled by Network Rail Limited. The Company has therefore, not separately disclosed transactions with other Group companies and investments of the Group qualifying as related parties for that period.

The results of Network Rail Limited (the ultimate parent company) are being consolidated by the SRA. Transactions with the SRA include receipt of grant payments and rental payments for leasehold buildings. David Bailey, a director of the SRA, is also a director of the Company.

Company Information

Network Rail Infrastructure Limited

Financial calendar 2003/04

31 March 2003	Publication of 2003 Business Plan
28 May 2003	Preliminary Results announcement
November 2003	Results for half year to 30 September 2003 announced
31 March 2004	Publication of 2004 Business Plan

Registered Office:

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