



**Delivering
for you**

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Network Rail helps bring the country together. We own, operate, maintain and invest in Britain's rail network. Increasingly we are delivering improved standards of safety, reliability and efficiency. This benefits our customers and society at large.

Every day. Everywhere.

Britain's rail network is increasingly successful

It is the busiest it has been for 50 years. The number of passengers has increased over 40 per cent in the last 10 years and the amount of freight is up nearly 60 per cent.

When we took responsibility for the network in 2002, we said it would take 18 months to show major improvements and three to five years to achieve a sustainable level of efficiency and performance. We are now approaching the end of that process.

We have achieved major improvements in safety – the number of broken rails is now at the lowest recorded level ever, and the risk from signals passed at danger has decreased 90 per cent since 2001.

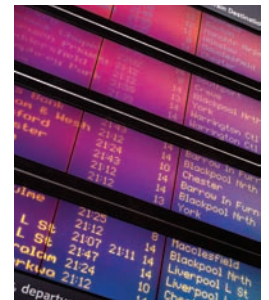
Train punctuality is at its highest for seven years.

We are proud of the success we have achieved so far, but there is clearly much more to be done.

Improving performance and increasing demand brings its own challenges. In many areas – London, the South East, Birmingham, Manchester, Leeds and on intercity services, for example – crowding is now a growing issue.

We have a key part to play, alongside the train and freight operating companies, in growing the railway and delivering a world class service.

And we must continue to concentrate on safety, reliability and efficiency.



Our performance

Safety

Rail travel is the safest form of transport in Britain

Despite the tragic incident in Cumbria in February 2007, the railway is safer than it has ever been and is the safest form of transport in Britain. Safety remains our number one priority and we will continue to do everything in our power to maintain and improve performance.

8th

consecutive annual reduction in number of broken rails – now at lowest recorded rate, as we use better information to move from ‘find and fix’ to ‘predict and prevent’

90%

decrease in the risk from signals passed at danger since 2001, thanks to the introduction of TPWS and TPWS+

164%

Level crossings represent the greatest remaining area of risk on the railways. Our targeted and hard hitting ‘Don’t run the risk’ campaign has raised public awareness of the dangers of incorrect level crossing use by 66 per cent nationally and 164 per cent in the hotspots

Reliability

Train punctuality is at its highest for seven years

Improvements in performance to date are the result of hard work by everybody involved in the railway – its infrastructure and the trains that use it. A key part of this has been the success of joint planning and delivery processes between us and the train operators. We are confident that our 90 per cent punctuality target is achievable, however further improvement will become increasingly difficult.

28%

reduction in Network Rail train delays since we took over in 2002/03, although overall delay minutes last year, at 10.5m, were the same as in 2005/06

88%

of trains arrive on time, the highest level for seven years. We are targeting 90 per cent within the next two years

Efficiency

Strong financial performance enables us to invest more in enhanced capacity and longer term efficiency

We have made good progress in driving out costs from the business, stripping £1.3 billion from the cost base and substantially reducing the unit cost of investment in the railway. Further reductions in controllable costs will enable us to make investments to reduce the longer term cost of the railway while increasing capacity, maintenance and renewals. Tight cost control however, must be combined with continuous improvement in assets and performance.

£1.5bn

profit before tax. Because we are a not for dividend company, that profit is being ploughed back into the railway

£2.4bn

to be spent on enhancements over the next two years to increase capacity and improve station facilities

£3.3bn

capital investment in the railway this year

Financial highlights

for the year ended 31 March 2007

	2007 £m	2006 £m
Revenue	5,795	3,837
Operating profit	2,278	468
Profit/(loss) before taxation	1,478	(232)
Profit/(loss) after taxation	1,035	(253)
Net cash from operating activities	2,428	655
Net debt	(18,394)	(18,201)
Net assets	5,658	4,363
Railway network fixed assets	28,304	25,991
Investment property	948	892
Capital expenditure	3,326	3,151

People

Over 33,000 people delivering on behalf of the nation

Thanks to the efforts of our employees, the railway system carries some three million people every day and 20 billion tonne kilometres of freight every year. We are investing heavily in training, apprenticeship schemes and career development to improve the performance of our business.



7,000

employees will have completed leadership development courses at Westwood, our leadership development centre in Coventry, by the end of the year

0.26

employee accidents per 100,000 hours worked. Put another way, on average an employee would have to work nearly 200 years per reportable accident

Safety is our number one priority



Chairman's statement



Ian McAllister, Chairman

The improving performance of the railway in recent years has led to ever-growing demand from passengers and freight users.

The performance of Network Rail, and of the railway network, has improved further in the last year. Train punctuality has continued to increase and the financial efficiency of the Company is getting better, as these full year results demonstrate. Furthermore, the network is benefiting from record investment to meet the growing demands of passengers and freight users.

Unfortunately no review of the year would be complete without remembering the tragic incident at Grayrigg in Cumbria on the evening of Friday 23 February. A Virgin Trains service from London-Glasgow derailed on a set of points causing one fatality and many injuries. As soon as the immediate cause of the derailment became clear, Network Rail took full responsibility for the incident and apologised to those affected.

The Grayrigg derailment was a tragedy but it should not make us lose sight of the fact that the railway is now safer than it has ever been, and more importantly, that it is the safest form of transport. Safety indicators continue to improve, with broken rails once again at their lowest ever level.

There was further improvement in train punctuality again this year, with 88.1 per cent of trains arriving on time compared to 86.4 per cent in the previous year. This represents a tremendous improvement compared to when Network Rail took over responsibility for the rail infrastructure in 2002.

Alongside maintaining high levels of safety and train punctuality, it is also vital that Network Rail has continued to improve the financial efficiency of the railway. The savings achieved have contributed to the significant profitability of Network Rail, with £1bn of post-tax profits during 2006/07. This money has already been re-invested in the railway, helping to fund Network Rail's £3.3bn capital investment programme, and is a tangible benefit of the Company's not-for-dividend status.

The improving performance of the railway in recent years has led to ever-growing demand from passengers and freight users. This is excellent news, but presents the railway industry with a significant challenge as we seek to increase the capacity of the railway to meet this growing demand.

In the 2007 Business Plan Network Rail announced that for the first time since privatisation, more money will be spent on enhancing the network than on maintaining it over the next two years. This autumn the Company will publish its Strategic Business Plan for 2009/14 which will outline proposals to grow the network with major expansion plans for routes like Thameslink and stations like Birmingham New Street.

Following the acquisition of Railtrack, Network Rail inherited its predecessor's liabilities. This included the ongoing health and safety prosecution in relation to the tragic incident at Ladbroke Grove in 1999 which resulted in the death of 31 people. This prosecution concluded this year with Network Rail apologising for Railtrack's failings and pleading guilty to an offence under the Health & Safety at Work Act. The Court fined the Company £4m.

The challenge of the future is one of capacity.

In the coming months there will be a number of changes to the Board of Network Rail. Most prominent amongst these will be the retirement in July of the Chief Executive John Armitt. John has been an outstanding Chief Executive over the last five years. He took on a Company that was struggling and leaves one which is successful. His fellow Board members wish him well for the future.

John will be replaced by Iain Coucher, the present Deputy Chief Executive. Iain has been in his current role for more than four years and has been one of the key figures in the Executive team that has transformed the business. I am certain he will be an excellent Chief Executive, and Network Rail is fortunate in having such a strong internal candidate to replace John.

In addition to John's departure two non-executive Directors, Rob den Besten and Chuck Hoppe, are also retiring this summer. I would like to thank them both for their substantial contribution to the work of the Board.

Today's railway is a thriving railway. In recent years the performance of the network has improved substantially and it continues to do so. The financial performance announced by Network Rail today reinforces those achievements. The challenge of the future is one of capacity. Network Rail is determined to work with train operators and the Government to continue to grow the network and meet the aspirations of passengers and freight users alike.



Ian McAllister
Chairman
24 May 2007

Chief Executive's review



John Armit, Chief Executive

This will be my last annual review as Chief Executive of Network Rail. Since taking on the role in December 2001, I have witnessed a railway which has transformed the quality of the service it delivers to passengers and freight users with a massive improvement in the proportion of trains arriving on time and a tremendous investment in the quality of the network. I am proud to have played my part and to have led the Network Rail team in delivering these improvements.

Over the last year, this improvement has continued with better train punctuality and the improved financial performance which these results illustrate. Regrettably, and despite a safety record which in other respects remains excellent, the year has been overshadowed by the tragic Grayrigg derailment which resulted in one fatality.

Safety

As the Chairman discussed in his review, as soon as the immediate cause was clear Network Rail accepted responsibility for the derailment and apologised to everyone affected. The whole organisation was devastated to conclude that the condition of Lambrigg points caused the accident.

The Rail Accident Investigation Branch and British Transport Police continue to investigate the derailment, as does Network Rail, in order to understand fully the reasons that the set of points came to be in such a poor condition.

Notwithstanding the tragedy at Grayrigg, we should not overlook the fact that the safety record of the railways is very strong. Prior to the derailment, it had been five years since the last accident caused by a failure of the railway and some five billion passengers had been safely carried in that time. This record means that the railway is now safer than it has ever been, and that rail is now the safest mode of transport in Britain.

The number of broken rails fell again last year and is at the lowest ever level. In total, there were 192 broken rails last year compared to 317 during the previous year and a peak of 952 in 1998/99. That the improvement was so substantial is due to a combination of factors including the volume of new rail laid in recent years and improved rail inspection, as well as being partly due to the absence of extreme cold weather in the winter. It is difficult to see significant further reductions beyond this level.

In recent years the Company has been particularly determined to improve the levels of workforce safety but each year there had been a number of fatalities amongst track workers. It was pleasing, therefore, that last year the Accident Frequency Rate (AFR) improved to better than our target level, and there were zero workforce fatalities. The satisfaction at this good year-end performance quickly turned to sadness with the death of a Network Rail track worker in an incident near Maidenhead in April. This incident provides a tragic reminder that there is absolutely no room for complacency in our drive to improve workforce safety.

Performance

When I was appointed as Chief Executive some five-and-a-half years ago, only 77 per cent of trains were arriving on time. Improving this unacceptable performance was the top priority for Network Rail, and in the last twelve months, 88.1 per cent of trains arrived on time. The Company is well on the way to our objective of 90 per cent average punctuality over a full year before the end of the Control Period in March 2009.

High levels of investment in the railway assets have continued during the year, with £3.3bn spent on the renewal and enhancement of the infrastructure.

Network Rail delay minutes have also fallen substantially over the period, from 14.7m minutes during the first year of Network Rail to 10.5m minutes last year. That this represents the same level of performance as during the previous year is a disappointment. However, delays from infrastructure faults continue to reduce and the overall performance include an increase in delays caused by external factors beyond Network Rail control of 700,000 minutes.

That punctuality has continued to increase is due to the improved performance from the train operators in the last year, and the improved way in which Network Rail and the train operators are working together in the interests of passengers including through integrated control centres. Future performance improvement will require ever closer partnership between Network Rail and train operators, something to which both partners are committed.

This year's performance is better than the ORR's target of 10.6m minutes for the year, although falls short of Network Rail's stretching internal target which aimed for 9.8m minutes. The whole Company is absolutely focused on returning to the trajectory of year-on-year reductions in delay minutes in the year ahead.

Freight

Whilst there is a great deal of public attention on the passenger railway, Network Rail is equally focused on delivering a railway for freight use.

A key milestone came in March 2007, when Network Rail published its Route Utilisation Strategy for freight which set out proposals for the development of the freight network including the enhancement of a number of routes to carry the larger 'high cube' 9'6" W10 containers. A number of these schemes are being developed with funding from Network Rail resources, whilst others are being progressed through the Department for Transport's Transport Innovation Fund.

In addition to this longer-term plan for the expansion of the rail freight market, there were also a number of positive developments during the past year. We were particularly pleased that Eddie Stobart initiated a new partnership with Tesco to switch much of their Anglo-Scottish freight from road to rail. Over the three years of this contract, this will replace 39,000 lorry journeys and save three million road miles per year.

Working with the freight operators, we have begun a review of unused freight train paths which has led to some 800 paths being removed from the timetable to free up space for growth. These paths will now be available for use by other freight and passenger services, supporting Network Rail's ambitions to grow the capacity of the railway.

Freight volumes on rail were broadly comparable with the preceding year at a level more than 60 per cent higher than when the industry was privatised in the mid-1990s. Container traffic from deep-sea ports was particularly strong in the past year with another 5 per cent annual rise to new record levels.

Cost control

Alongside improving the punctuality of train services, one of the enduring priorities during the last five years has been improving the cost efficiency of the railway. Reducing the cost of the day-to-day railway will free up resources to be spent on investment and on growing the network, allowing the railway to prosper in the future.

In the last year a £63m saving in operating expenditure excluding depreciation was made in real terms. This builds on previous improvements and Network Rail has now made a 24 per cent efficiency saving over the past three years, and is committed to meeting the ORR target of 31 per cent efficiency improvement over five years from April 2004.

Train punctuality is at its highest for more than seven years, costs have come down and the railway is now safer than it has ever been before.

These efficiency savings have contributed to the substantial profit that Network Rail is able to announce in these accounts. However the biggest driver of our improved financial performance is a consequence of the Company agreeing to defer some of its income from the Government for the first two years of the Control Period. During this time, Network Rail made significant losses but to compensate, the Company's income is now higher for the next three years and this has contributed to our move into profit. On a post-tax basis, Network Rail made profits of £1bn over the year, as is detailed by the Group Finance Director on page 10.

Network Rail's profits are not distributed to shareholders but are used to either reduce debt or re-invest in the railway. The Company's profitability has contributed to a £3.3bn investment programme and led to a reduced borrowing requirement.

Whilst the financial efficiency of Network Rail has improved in the last year, the financial efficiency index target has been missed for the first time. Until February the Company had been on course to meet this target, however the financial impact of the derailment at Grayrigg means the target was narrowly missed.

Improving the railway assets

High levels of investment in the railway assets have continued during the year, with £3.3bn spent on the renewal and enhancement of the infrastructure. Indeed, over the last five years renewals volumes have been at a higher level, on a consistent and sustained basis, than probably ever before. This has been one of the main contributors to the improving safety and performance of the network.

In the last year, some 639 miles of new rail, 528 miles of new ballast, and 476 units of new switches and crossings have been laid. These high volumes have resulted in continued improvement in the condition of the railway assets. Aside from the substantial reduction in broken rails which are detailed elsewhere, point and track circuit failures, and signalling failures, continue to reduce, building on the improvements of previous years.

These improvements in asset condition have resulted in Network Rail meeting both its target, and its stretch target, for asset condition.

Growing the railway

As the performance of the railway has improved in recent years, with much improved punctuality and comfortable new rolling stock, passenger numbers and the demand from freight has also increased significantly. In fact, passenger numbers have increased by more than 50 per cent since the mid-1990s and the network is carrying more passengers than at any time since 1946.

It is vital that the railway industry responds to this growing demand with an ambitious agenda to grow the capacity of the network. Indeed the shift in priorities towards growing capacity is one of the main changes I have seen in the last five years.

Both short and long term solutions to the capacity challenge are required. In April, Network Rail announced £2.4bn of expenditure on enhancements over the next two years to meet the short term requirements for extra and longer platforms, and for better station facilities and improved infrastructure for freight. The longer-term solutions require a funding decision from the Government as part of the ORR's review of Network Rail's funding requirement for 2009/14. Network Rail will publish its long term proposals for growing the railway in the autumn.

In Scotland the work to provide greater capacity at Edinburgh Waverley has continued in the last year. In addition, Network Rail was delighted to have promoted the Bill to construct a new railway line from Airdrie to Bathgate. Approval from the Scottish Parliament was received in March, and construction of the new line will commence in the coming year.

The upgrade of the West Coast mainline continues, with the four-tracking of the Trent Valley progressing well and due for completion during 2008/09. The line upgrade has already delivered substantial benefits to passengers, including reduced journey times. Further improvements including more frequent services and further reductions in journey times will come with the next West Coast timetable change in December 2008.

Transforming Network Rail

When Network Rail took over responsibility for the rail network, the focus was rightly on fixing the problems of the past. Nearly five years on, attention is shifting to meeting the challenges of the future.

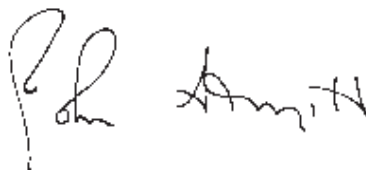
In order to equip Network Rail to meet these future challenges the Company has embarked on a transformation programme to define our vision for the future and develop the right skills and the right processes to deliver it. The programme will cover every aspect of Network Rail's performance, and is described in the 2007 Business Plan. The programme is a response to the need to create a sustainable transport system for Britain with Network Rail becoming a world class organisation delivering for passengers and freight users seven days a week.

Outlook

It has been a privilege to lead Network Rail over the last five years, and I shall depart the Company with a mixture of pride and sadness. We have achieved a great deal together. Train punctuality is at its highest for more than seven years, costs have come down and the railway is now safer than it has ever been before. I am proud to have played my part in this success. The railway is thriving and the new challenge is to grow the network to continue to meet the ever-rising demand from passengers and freight.

I am very pleased to hand over the reins to such an able successor as Iain Coucher. The Network Rail team has been a powerful one, and I know it will go from strength to strength under his leadership and meet the challenges of the future.

It is hard to think of a group of employees who are more passionate about the service their Company provides than those of Network Rail. I am honoured to have led them, and know that their commitment to meet the needs of rail users will be undiminished in the years ahead.



John Armitt
Chief Executive
24 May 2007

Group Finance Director's review



Ron Henderson, Group Finance Director

The year ended 31 March 2007 has produced a bottom line profit for the company, as forecast in our business plan. The key reason for this move from a loss making position is the cessation of the revenue grant deferral agreed with the Department for Transport (DfT) and the Office of Rail Regulation (ORR) but this should not mask another year of real cost reduction and investment efficiency.

It is important to reiterate that the challenge of meeting our efficiency targets set by the ORR continues to be our key financial focus. Savings continue to be delivered by our regime of strong budgetary control, minimising inefficient and discretionary spend and improving the understanding of our cost bases and cost drivers. We are still ahead of our targeted efficiencies but the further efficiencies required in years 4 and 5 of the Control Period, in order to meet fully the ORR's challenge of 31 per cent reductions by 31 March 2009, will become progressively tougher to deliver. We remain committed to the delivery of these financial targets, as outlined in our recently published Business Plan and remain confident that they will be substantially achieved.

Financial performance

Financial highlights

- Turnover was £5,795m, an increase of £1,958m against prior year turnover of £3,837m. The substantial increase was as a result of the cessation of revenue grant deferral, the instigation of repayments of the grant deferred in years one and two of the control period and an increase in track access charges as agreed in the ORR determination;
- operating costs before depreciation totalled £2,462m, an increase of £31m compared to the prior year total of £2,431m but a reduction in real terms of some £63m;

- profits of £47m were achieved from the sale of properties (2005/06: £61m);
- net interest charges have increased to £902m from £778m reflecting the increased average levels of debt in the year and increased borrowing costs;
- profit before tax was £1,478m compared to a loss of £232m in the prior year. After a tax charge of £443m (2005/06: £21m) profit for the year was £1,035m (2005/06: loss of £253m);
- net debt increased to £18.4bn from £18.2bn in the year;
- total non-current assets have increased from £27.5bn to £29.7bn. This includes investment properties valued at £948m, an increase of £56m from the previous year's valuation of £892m and financial assets of £405m (2005/06: £571m); and
- net assets at 31 March 2007 totalled £5.66bn (2005/06: £4.36bn).

Another year of real cost reduction and investment efficiency.

Performance against the ORR Control Period 3 determination

The table below outlines the outturn (in 2006/07 prices) on the key areas of expenditure for the business as defined within the Access Charges Review 2003.

Controllable opex and maintenance costs fell 5 per cent in real terms over the year. Controllable opex saw savings principally as a result of the continued reduction of agency staff and contractors and consultants, partly off-set by the related increase in staff costs. (Non-controllable opex costs were higher than

Progress towards ORR's 31 per cent target

Category	31.03.05 £m	31.03.06 £m	31.03.07 £m	Cumulative progress
Controllable Opex	994	899	878	25%
Maintenance	1,352	1,238	1,146	24%*
Renewals (excluding West Coast)	1,721	2,077	2,419	23%
Overall efficiency (ORR year 3 target: 22%)				24%

* After accounting for the impact of traffic growth the saving increases to 26 per cent.

in 2005/06 and are currently 39 per cent worse than the ORR determination which is primarily due to the increasing costs of electricity. Additional expenditure was also made on BT Police as part of our programme to make stations safer for the travelling public.)

Maintenance costs continue to reduce with more maintenance work being delivered for less money. Expenditure has reduced as a result of embedding the more favourable commercial terms established last year. Benefits were felt from enhanced planning and subsequent sharing of overheads as the capital investment portfolio delivered by maintenance increased. Additionally we continued to release labour and specialist contractors and rely more on our own in-house staff. Work on the maintenance unit cost (MUC) structure has continued during 2006/07, with consistency of methodology and data input now being the key focus. Progressing this, and increasing the 53 per cent coverage of the MUC framework, will continue during 2007/08.

Assessing the efficiency of our renewals programme is complex. The level and nature of activity that is required over the Control Period is not constant and trends in expenditure alone cannot provide an indication of efficiency. Our efficiency assessment draws on both unit cost indices and budget variance analysis.

The year under review delivered substantial, cost-efficient investment with some £3.3bn of renewals and enhancements. The increasing use of innovative delivery and contracting mechanisms, as well as the contribution from high-output plant and equipment, is laying solid foundations to deliver further efficiencies in the medium to long term. We have continued developing and populating our Cost Analysis Framework, which increasingly will provide consistent volume and unit cost collection, to produce a central database of all emerging actual data.

We reported last year that it was becoming apparent that we would struggle to meet the ORR target on track

renewals and the year under review has borne this out. Whilst significant progress has been made in improving the track renewals performance delivered by Network Rail and its supply base, it was recognised earlier this year that further steps needed to be taken to continue to drive performance towards world class standards and help us to realise our targets. These build on some of the initiatives introduced over the past four years, such as high output mechanisation and future planned initiatives, such as modular switches and crossings.

We have completed the Southern Power Upgrade project on time and below budget. The West Coast Route Modernisation project has also seen further successes this year as we continue to deliver its outputs on time, improving travelling times, reliability and punctuality of the service on the route. Although not without its difficulties, we are striving to maintain focus on the demanding savings in overall cost set by the ORR.

Key performance indicator – Financial Efficiency Index

Despite an increase in efficiencies this year the company failed for the first time to deliver its targeted Financial Efficiency Index (FEI). The FEI is a weighted index of controllable opex, maintenance and plain line track renewal costs which broadly measures the value for money of the company's spend in relation to prior years. This year's target of 1,877 represented an improvement of 4.8 per cent against the prior year outturn of 1,972 and the final FEI at 31 March 2007 stands at 1,904, an actual improvement of some 3.4 per cent. Excluding the impact of the derailment at Grayrigg would have resulted in an FEI of 1,874, a reduction of 5 per cent and better than the target for the year.

Carrying value of the railway network

The value of railway fixed assets has increased by £2.31bn from £25.99bn to £28.30bn. The increase in the carrying value reflects capital expenditure of £3.3bn less depreciation of £1.1bn and a small upwards revaluation of £0.1bn.

Under depreciated replacement cost accounting the network is valued in the accounts at the lower of its same state replacement cost (which is estimated at circa £63bn) and its value in use. This value in use is based on a discounted future cash flow that assesses the value to the business of the net income stream produced by the railway network. This is a function of the Regulatory Asset Base (RAB) set by the ORR and, as such, this RAB is used as a proxy for that value together with appropriate adjustment for any forecast cash flow variance from the determination.

Pensions

Included within the income statement for the period is a charge of £104m (2005/06: £136m) in respect of pension costs of which £121m (2005/06: £115m) represents service costs and £17m is a net interest return on assets (2005/06: £21m loss). The balance sheet liability, which represents the Company's share (60 per cent) of the full deficit of the Network Rail section of the Railway Pension Scheme (RPS), fell from £359m to £248m. The scheme is still in deficit and the latest accounting shortfall represents 12 per cent of the total scheme liabilities.

Taxation

For the first time Network Rail has a current corporation tax charge of £11m on non trade income (mainly property sales) less advance corporation tax which had previously been written off of £7m leaving a liability payable of £4m. The main trade income is covered by tax losses brought forward. There is also a liability in respect of interest receivable from Network Rail Holdco PLC against which group relief will be claimed. The remaining charge is a deferred tax liability of which £424m arises primarily as a result of timing differences arising from accelerated tax depreciation and utilisation of brought forward trading losses.

The Chancellor's Budget in March 2007 proposed certain changes in relation to future corporation tax rates and future capital allowances. As these changes were not substantively enacted at the balance sheet date their impact has not been recognised in these accounts.

Cash flow

During the year the Company's operating activities generated cash of £2.4bn (2005/06: £0.7bn). Spending on fixed assets totalled £3.3bn (2005/06: £3.1bn).

Accounting policies

Significant accounting policies are set out in Note 2 to the financial statements.

Funding

Network Rail's principal financing vehicle is Network Rail Infrastructure Finance PLC (NRIF), a special purpose financing company, which acts as the issuer under Network Rail's Debt Issuance Programme (DIP) and is not a member of the Network Rail group, although for accounting purposes NRIF is treated as a subsidiary in the consolidated accounts of Network Rail Infrastructure Limited.

The DIP is supported by a financial indemnity from the Secretary of State for Transport which expires in 2052. As at 31 March 2007, all Network Rail's debt sits under the DIP other than £4.8bn equivalent of medium term notes which sit under Network Rail MTN Finance PLC. Within the DIP is a £20bn note programme which has been highly rated (AAA by Standard and Poors, Aaa by Moody's and AAA by Fitch).

The DIP allows access, through a single platform, to the widest possible sources of funding, at the lowest possible cost, including the long term capital markets. This gives Network Rail a stable base for funding a continuing programme of long term investment in the national rail network.

During the year ended 31 March 2007 £3bn of bonds have been issued under the DIP in a number of currencies (£ Sterling, US Dollars, Australian Dollars,

Japanese Yen, Norwegian Krone and Swiss Francs) and in a number of maturities. All non-sterling public issuance under the programme was swapped into fixed sterling interest rates as at the balance sheet date to protect against movements in interest and foreign exchange rates.

The Company had £5bn of undrawn committed facilities available at 31 March 2007 through the DIP working capital facility (£1bn) and the Secretary of State for Transport standby facility A (£4bn). The Secretary of State for Transport standby facility is undrawn and will only be called upon as a last resort.

In April 2007 Network Rail launched a new programme of RPI index-linked bond issuance under the Company's Debt Issuance Programme. The majority of Network Rail's revenues are linked to inflation so aligning debt cost to income is a prudent, cost effective way of financing the railways over the long term.

Financial instruments

The Group and Company uses derivative financial instruments to reduce exposure to foreign exchange risk and interest rate movements. This is in accordance with a comprehensive risk management process which is monitored by the Board and includes documented treasury policies, counterparty limits, controlling and reporting structures.

Derivative financial instruments are marked to market in accordance with IAS (International Accounting Standards) 39 Financial Instruments: Recognition and Measurement and their value is shown on the face of the balance sheet. Those that are designated as part of a cash flow hedge accounting arrangement are measured for effectiveness and to the extent that they are statistically effective, in removing foreign exchange and interest rate risk, these movements are reflected in the hedge reserve and shown on the face of the statement of recognised income and expense (SORIE). It should be noted that changes in the value of a hedging derivative should mirror movements in the value of the underlying hedged item.

Movements in fair value on instruments that qualify for cash flow hedge accounting under IAS 39 are recognised directly in equity to the extent the hedging is effective for accounting purposes. These movements are reflected in the SORIE. Instruments not qualifying for cash flow hedge accounting and ineffective portions of hedge relationships are recorded in the income statement. The Group has successfully implemented hedge accounting for its Medium Term Note and Debt Issuance Programme bonds. The net fair value of derivatives on the Group's balance sheet at 31 March 2007 was a liability of £262m (2005/06: asset of £68m) based on a notional value of swaps of £11.8bn (2005/06 £9.8bn). The net impact on the Group's income statement of IAS 32 Financial Instruments: Disclosure and Presentation and IAS 39 in the year ended 31 March 2007 was an expense of £25m (2005/06: £10m).

In the year the SORIE shows that Group's cash flow hedges reduced in value by £183m. This was largely due to the strength of sterling, particularly against the US dollar. As a result £351m of foreign exchange gains in the underlying debt being hedged were also recognised in reserves and the SORIE. The reason that the gains and losses in the accounts are not equal and opposite is that the hedging instrument protects against movements in interest rates as well as foreign exchange. It follows that if the value of the derivative was split into its constituent parts it would show around £351m of foreign exchange gains foregone and around £168m of additional interest saved.

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.

Group policy is to ensure that there are sufficient facilities and short-term investments to cover, as a minimum, the next 12 months' funding requirements.

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

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

The Group's primary liquidity is provided by committed bank facilities. At 31 March 2007, the Group had £1bn in undrawn committed bank facilities. The Group also has access to c. £750m bank facility which is used to support the Company's commercial paper programme.

Summary

The year under review, in financial terms, has been a year of solid and anticipated progress. We have continued the efficiency drive towards meeting the ORR target of 31 per cent and made further inroads in terms of establishing a unit costing framework for our key areas of investment and maintenance spend. Similarly good progress has been made in our planning for Control Period 4. Our financial focus going forward remains to deliver the final savings to meet the targets set by ORR and to secure an equitable and deliverable determination for the five years to 31 March 2014.



Ron Henderson
Group Finance Director
24 May 2007

The year under review, in financial terms, has been a year of solid and anticipated progress.

Directors' report

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

As such, it is publishing this Report and audited Accounts which contain information required to be disclosed by a listed 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, the Chief Executive's review and the Group Finance Director's review. This report should also be read in conjunction with the Corporate Governance Report and the Directors' Remuneration Report.

Business review and principal activities

Network Rail Infrastructure Limited has responsibility for the management of the national rail infrastructure. Its principal activities are the operation, maintenance, renewal and, in co-operation with train operators and funders, the development or enhancement of the national rail network and in particular:

- provision to train operators of railway track access;
- management of train timetabling, train planning and signalling; and
- maintenance, renewal and enhancement of the infrastructure and undertaking major capital programmes.

In June 2005 the relevant provisions of the Railways Act 2005 came into force facilitating a number of significant changes to the structure and organisation of the railway. These included giving Network Rail additional responsibilities for industry performance, planning and projects. The changes are designed to deliver improvements in reliability and the effectiveness of industry planning, building on the already close collaboration between Network Rail and train operators.

Significant events subsequent to 31 March 2007

On 3 April 2007 Network Rail launched its Business Plan 2007 articulating the priorities for Network Rail over the current regulatory Control Period.

Results

The profit before tax was £1,478m (2005/06: loss of £232m) and the profit after tax was £1,035m (2005/06: loss of £253m). Further details of the financial results can be found in the financial statements commencing on page 42.

Share capital

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

Key future issues

Network Rail's key priority is to deliver a safe, reliable and efficient railway working with our industry partners to provide acceptable and improving levels of performance. Looking forward it intends to achieve further sustainable improvements for its customers, employees and wider stakeholders as well as seeking ways to meet where possible the increases in demand for both passenger and freight traffic.

With its responsibilities relating to the national rail network (including the additional responsibilities for industry performance, planning and projects placed upon it as a consequence of the 2004 Rail Review), Network Rail has a pivotal role in a complex industry. The way in which it looks after its assets affects a wide range of people and Network Rail works collaboratively with its customers and funders to facilitate the delivery of their plans. It needs also to work with its stakeholders to take account, where possible, of the wider social impacts of the operation of the national rail infrastructure.

Of the issues facing Network Rail in the future the following are key to the deliverability of its objectives:

Safety

Rail travel is safer than it has ever been and safety remains Network Rail's highest priority. The Rail Industry's Annual Safety Performance report published in May 2006 identified rail as the safest form of transport in Britain. The tragic incident

in Cumbria on 23 February this year is a reminder, however, of the need for constant vigilance in maintaining the safety of the railway.

Continuing improvement has been made over the past four years in most of the key safety performance indicators. The risk from signals passed at danger is down 90 per cent since 2001, due largely to the introduction of technology – TPWS and TPWS+. The number of broken rails is at an all time low.

There was no workforce fatality in 2006/07 and the safety environment for working on the railway is improving. This is due in part to safety awareness campaigns focusing on raising the profile of safety within Network Rail and contractor teams and other initiatives designed to develop safety cultural and behavioural changes. The workforce accident rate has declined markedly over the last two years, and improved by a further 25 per cent in the past year. At the end of 2006/07 the rate was down to less than 0.3 reportable accidents per 100,000 hours worked. Sadly in April 2007 an employee died whilst working on the track. Constant attention to this important aspect of the railway is required and the Company remains committed to on-going focus on safer working practices.

Network Rail's 'Safety in the Line' programme was implemented during the year. This is designed to embed safety accountability improvements and decision-making more fully into the key delivery functions within the Company. It represents the most significant component of Network Rail's strategy to deliver a step change in safety performance.

The biggest risk on the railway is now at level crossings and during last year Network Rail launched a national level crossing awareness campaign. Lobbying by Network Rail also resulted in additional provisions being included in new road safety legislation aimed at assisting the reduction of this risk. Additional level crossing risk reduction

initiatives also continue to be developed including the evaluation of new detection technologies.

Service reliability and network capacity

Punctuality on the railway is at a seven year high. The average punctuality over the past year was above 88 per cent. Network Rail is predicting to hit its target of 90 per cent before the end of the current Control Period (31 March 2009).

Performance continues, however, to be a challenge. The improvements in performance to date are the result of the hard work of everyone involved in the operation and management of the railways – both Network Rail and the train operators. Joint planning and delivery processes between Network Rail and the train operators have contributed to this, as has the introduction of integrated control centres and bringing maintenance in-house.

This improvement in performance has come about despite continuous increases in the number of train services using the network. The demand for rail has grown strongly over the last ten years for both passengers and freight services. This trend in passenger demand has continued over the past year with all sectors showing a growth in total passenger kilometres, total passenger journeys and revenue compared to the previous year. This demand for rail travel has been reflected in the continued increase in timetabled train kilometres operated on the network. Likewise, both freight moved and lifted have mirrored past trends and grown over the past year.

As a consequence, the network is increasingly congested and at peak times of the day there is no spare capacity on certain sectors of the network. Levels of overcrowding are worsening as a consequence of this demand. As well as the effect on train passenger capacity this demand is also creating increasing congestion on the station platforms and concourses.

For the longer term Network Rail is developing plans with train operators and funders to increase capacity. Key to understanding the options to address these issues is the programme of Route Utilisation Strategies (RUSs) which we are taking forward in conjunction with our

industry partners. These take a strategic look at the rail network and its timetable and form the analytical and consultation process by which options are evaluated to balance capacity, passenger and freight demand, operational performance and cost.

Implementing the necessary enhancements of the infrastructure to cope with the rising demand will require the industry to achieve a consensus on the right solutions. These solutions must offer good value for money and be affordable to funders. Proposals for this will be set out in Network Rail's Strategic Business Plan to be published in October 2007.

Asset stewardship

One of the major components of Network Rail's improvement plans is reliability and long term sustainability of the network. This requires successful delivery of Network Rail's asset management responsibilities within the constraints of the available funds as well as being consistent with the reasonable requirements of its stakeholders. Development and implementation of the asset management activities involves comprehensive understanding of the criteria and systematic organisation in their delivery. Focus is on tackling the root causes of long-standing issues that affect asset performance. In particular, components that are not sufficiently reliable will be progressively replaced. The rate of improvement, however, will inevitably be slow. This year's experience has shown that several of the measures for asset reliability are now at a level where the impact of adverse weather can significantly affect the performance measures. This provides both risk and opportunities with strategies being developed to minimise the effects of adverse weather wherever possible.

Recognising that some of the measures used to monitor asset stewardship may be nearing the end of their usefulness (because they are stabilising at optimum levels), Network Rail has started a review of these measures to determine what will be more fit for purpose for the next Control Period. It is anticipated that these will measure precursors to failure, rather than failures themselves. This is in line with our strategy of "predict and prevent" rather than "find and fix".

Efficiency

Excellent progress has been made in delivering efficiency savings with reductions in both Network Rail's cost base and the unit cost of investment in the railway being achieved.

Technological innovation is an integral part of improving the business. Network Rail is engaging with European rail bodies to examine long term asset strategies, and working with suppliers and academia to explore climate change and sustainability improvements. It is also examining the opportunities afforded by improved communication technology and exploring the application to the railway of innovations developed in other industries.

There is a challenge, however, to delivering the further savings which are required in the remainder of this Control Period. Also beyond this, Network Rail needs to focus on what can be achieved in the next Control Period. We need to reach a challenging but realistic view of our plans and provide evidence to justify this view to help inform the ORR's review process which will lead to its determination for the next Control Period (the 2008 Periodic Review).

Sustainability

Transport has a major role to play in supporting economic, environmental and social objectives. Given that rail transport itself is more sustainable than alternative modes for many transport needs, the rail industry must promote rail usage by improving the rail product and its affordability in order for it to contribute to sustainability.

Funding and financing

Network Rail's net debt was £18.4bn at 31 March 2007 and is forecast to increase to over £20.4bn by March 2008 and by the end of this Control Period reach £21.9bn. This is less than forecast at the time of the last access charges review. It is anticipated that around £10bn will need to be raised over the next two years through a combination of public and private bonds issued under the debt issuance programme to cover the refinancing of existing debt as well as funding working capital. Hedging arrangements have been put in place to fix the Company's interest costs. Discussions are also taking place with Government and the ORR in relation to the possibility of raising debt without

the benefit of the Government indemnity in the context of wider discussions on Control Period 4. Further details of funding arrangements are set out in the Notes to the financial statements.

Stakeholder relationships and transformation

In the last couple of years Network Rail has built much better relationships with its stakeholders. It recognises, however, the need for continuing to strengthen this with rail users, its customers – the train operators, its wider stakeholders – government, funders, taxpayers, its suppliers and its staff. To achieve the goal of an affordable and sustainable railway requires these stakeholders' support and cooperation.

To deliver this Network Rail must have the right leadership and management and have people who share the same values and behaviours to create a world class organisation. A transformation programme is being developed to achieve this but this will take time and commitment throughout the Company to deliver.

Long-term planning

The challenges Network Rail faces require it to work with its industry partners to develop the right framework and culture in order to create and deliver the right whole industry solutions which represent best value, most cost-effective and sustainable strategies for the industry. These plans must inform and take account of the high level specifications from Government and the requirements of our other stakeholders.

In readiness for the 2008 Periodic Review, Network Rail is working closely with the Department for Transport and Transport Scotland to support the development of their High Level Output Specifications and associated funding. With the train operators we are also developing the appropriate whole industry strategies to deliver the required outputs at an affordable price. Plans for this will be set out in Network Rail's Strategic Business Plan in October 2007.

Performance indicators

The ORR sets certain regulatory financial and non-financial performance targets for Network Rail. The key performance indicators (KPIs) are summarised in the table below.

Further details can be found in the narrative below the tables and also more information is contained in the Business Plan 2007.

Performance indicators	Notes	2006/07	2005/06	2004/05
Safety				
Public Safety Index	1	0.581*	0.543**	0.503***
Performance				
Train Delay Minutes (million mins.)	2	10.5	10.5	11.5
Public Performance Measure	3	88.1%	86.4%	83.6%
Asset stewardship				
Asset Stewardship Incentive Index****	4	0.72	0.80	0.90
Financial control				
Financial Efficiency Index****	5	1,904	1,972	2,144

1 In 2005/06 RSSB changed the method of calculation of the Public Safety Index. The figures quoted for 2006/07 and 2005/06 are based on the new calculation and are therefore not comparable with those shown for 2004/05.

2 Train Delay Minutes are the number of minutes of train delays attributable to Network Rail (rather than the train operating companies) as defined in the contractual performance regime with operators.

3 Public Performance Measure is the overall rail industry key performance indicator measuring punctuality and reliability of train performance. It shows the percentage of trains that arrive 'on time' at their final destination compared to the number of trains planned to run on a given day. 'On time' means arrival within 10 minutes of the planned destination time for long distance operators and within 5 minutes for London and south east or regional operators.

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

5 Financial Efficiency Index is a measure of the efficiency of operations, maintenance, track renewals and other key central expenditure.

* To 31 December 2006

** To 31 December 2005

*** To 31 December 2004

**** A lower figure represents an improvement.

Safety

Steady progress has been made in most of the key safety performance indicators as shown below.

Safety indicators	2006/07	2005/06	2004/05
Workforce fatalities	0	4	2
Severe Category A SPADs*	19	98	131
Broken rails	192	317	322
Collisions at level crossings	12	15	17
Significant train accidents	31	24	41
Passenger accidental fatalities**	7	3	9

* SPAD = signal passed at danger. Figure for 2006/07 is based on a new calculation and therefore is not comparable with those shown for 2004/05 and 2005/06. Current measurement is based on a 100 point scale.

** One of the passenger fatalities in 2006/07 was caused by a train accident. Five of the passenger fatalities in 2004/05 and none in 2005/06 were caused by train accidents.

Train performance

There are two measures relating to train performance – Train Delay Minutes being the number of minutes of train delays attributable to Network Rail and Public Performance Measure (PPM) being the percentage of trains arriving on time at their final destination.

In 2003 the ORR set a target for the Company to improve the reliability of the network by more than 30 per cent by 2008/09. Over the last three years, reliability has improved significantly and total delays caused by Network Rail in 2006/07 are around 10.5 million minutes and this is reflected in PPM which has improved to 88.1 per cent. Whilst this is in line with last year, it reflects a widely different performance between areas directly in Network Rail's control and the impact of external events. Looking forward the Company is aiming to achieve the target set by the ORR for 2008/09 a year early and also will seek to beat this target.

Asset stewardship

The Asset Stewardship Incentive Index is a basket of measures which are intended to capture the underlying condition of Network Rail's assets. This index continues to be significantly better than the ORR target and even better than the more challenging targets set in Network Rail's business plans and management incentive plans. In 2006/07 there was a particularly strong performance in the incidences of broken rails which are at their lowest ever level.

The targets for two elements of this index have been revised. As a result of significant improvement in the number of level two exceedences and track geometry in 2006/07 and further opportunities to correct underlying causes of track geometry faults, these targets have been made tougher for the next two years.

Some of the asset failure measures have not improved as much as anticipated. Signalling, points and track circuit failures were all affected by the exceptional hot weather during last summer. It is anticipated that current delivery plans will recover the lost ground and so the same target for 2006/07 has been kept for 2007/08.

Financial efficiency

The Financial Efficiency Index (FEI) is a measure of how efficiently Network Rail spends on operations, maintenance and track renewals. As efficiency improves the Company should spend less to deliver the same outputs and therefore the FEI should reduce. The current measure has limitations in that it only covers 60 per cent of the total operating, maintenance and renewals expenditure. Network Rail is committed to increasing coverage and, as a result, has revised the definition for 2007/08 to cover 68 per cent of this expenditure. Work continues to further widen the FEI in the future. Also to make the measure more meaningful over time the FEI has been turned into an index with the outturn for 2003/04 being equal to 1.00.

Business performance

Network Rail believes that business performance improvement is dependent in part on the development of key skills and behaviours of employees. To improve these, investment is being made in a range of programmes.

To measure progress in behaviours an employee engagement survey has been developed. This survey is conducted each year, the most recent being in December 2006.

The results of this latest survey showed improvement in employee engagement against the previous results although falling short of the target. Further improvement is now being sought with a programme of communication of the results of the survey together with training and action plans to increase employee engagement. The next survey is scheduled to be conducted in December 2007 with further surveys planned for subsequent years.

Environment

Network Rail's approach is to focus on the key environmental issues facing it as operator of the rail infrastructure but also the issues facing society as a whole – climate change, waste, biodiversity and land management. It is committed to the on-going improvement of the railway's existing environmental record.

Its response to the challenge of managing environmental risk includes improving the lineside environment with

a policy of vegetation management that balances the responsibility to provide a safe and reliable railway whilst acknowledging the benefits of minimising the impact on the natural habitat. Its work with English Nature in this area continues. Waste management is also important with schemes in place to improve responsible waste handling and recycling both by the Company and by its contractors. Climate change is also an ongoing focus with participation in research programmes organised by various specialist bodies. Likewise energy and water usage are subjects of ongoing programmes of reduction.

Plans are being developed to create a framework within which environmental, societal and economic impacts are considered with a view to continuing to develop rail as a sustainable form of transport.

Health and safety

The health and safety of the Company's employees, whilst working within the business, and the public, whilst travelling on the railway infrastructure, are of great importance to Network Rail. The Company's policies and procedures relating to health and safety at work recognise the requirements of current legislation and are kept under constant review with the aim of providing a safe working environment for all employees. Significant resource is committed to safety, health and environmental matters and Network Rail aspires to continuing improvement of its performance in these areas. Further details of safety performance is set out on page 16 as well as in the Chief Executive's review on page 6.

Previous incidents

In October 2006 Network Rail Infrastructure Limited pleaded guilty to a health and safety charge in relation to the Ladbroke Grove collision in October 1999. On 30 March 2007 it was fined £4 million in respect of this charge. The derailment which took place at Potters Bar in May 2002 is the subject of continuing HMRI investigations; the outcome is unknown at present. The derailment in Cumbria in February 2007 is also the subject of investigation by the ORR as safety regulator; the outcome is unknown at present.

Corporate social responsibility

Network Rail is committed to carrying out its activities in a socially responsible manner in respect of customers, stakeholders, employees and local communities. As part of its objective of operating in a transparent and accountable environment, a report on these aspects within its business will be published in the autumn of 2007.

Network Rail also has an environmental policy as detailed in its Corporate Responsibility Report 2006. This is currently being reviewed.

Code of business conduct

The Company has adopted a code of business conduct that is applicable to all employees.

Research and development

During the year the Company charged £1m to the income statement (2005/06: £2m) on research and development. Other costs relating to significant development work have been capitalised in tangible fixed assets.

Directors and their interests

The Directors of the Company were appointed on the dates as shown in the table above.

Under the provisions of the Articles of Association of Network Rail Limited all Directors, except the Special Director (if appointed – there being no Special Director at the time of publication of this report), must retire by rotation, and may stand (together with any new Director appointed since the last general meeting) for re-election by the Members of that Company at least every three years. Save as shown in the table above there were no other changes to the Board during the year.

The biographical details of the Directors can be found on pages 20 and 21.

Directors' interests

The Directors have no interest in the Company.

Current Directors	Position	Date of first appointment	Next due date for re-election
Ian McAllister	Chairman	22 March 2002	July 2009
John Armitt	Chief Executive	3 October 2002	See Note 1
Iain Coucher	Deputy Chief Executive	22 March 2002	July 2009
Peter Henderson	Group Infrastructure Director	1 October 2002	July 2007
Ron Henderson	Group Finance Director	12 August 2002	July 2008
David Bailey	Non-Executive Director	15 August 2002	July 2008
Rob den Besten	Non-Executive Director	24 September 2003	See Note 2
Ian Buchan	Non-Executive Director	5 February 2006	July 2009
Yvonne Constance	Non-Executive Director	1 May 2005	July 2008
Jim Cornell	Non-Executive Director	3 October 2002	July 2009
Michael Firth	Non-Executive Director	4 December 2004	July 2008
Christopher Green	Non-Executive Director	26 June 2005	July 2008
Charles Hoppe	Non-Executive Director	1 August 2002	See Note 3

Notes

- 1 John Armitt will be retiring with effect on 31 July 2007.
- 2 Rob den Besten will be retiring with effect on 30 June 2007.
- 3 Charles Hoppe will be retiring with effect on 18 July 2007.

Employees

Details of the number of employees and related costs are set out in Note 7 to the financial statements on page 50.

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

Network Rail believes that success in achieving its objectives is influenced significantly by the skills, behaviour and attitude of its employees. Substantial investment is being dedicated by the Company to deliver high quality, accredited training and development programmes as a primary means of stimulating cultural change and management competence. Development programmes from apprenticeship schemes through to leadership skills are being implemented.

Effective communication in raising the level of employee engagement is also important. To do this a wide range of communications media is being used, encompassing local information cascades and briefings, videos, the Company newspaper, email news bulletins, electronic data links and briefings by the Directors to reach all our employees. During the Business Briefings conducted in January 2007 over 11,000 employees were able to attend the geographically spread briefings at which the Company's safety and operational performance were discussed and employees had the opportunity to question the Executive Directors and Chairman on any aspect of the business that they chose to raise. To monitor our progress we also conduct an annual survey of employee engagement with an active follow-up programme to address practical issues.

There is also a strong belief by the Board of the Company in the importance of consultation on issues affecting the workforce. Frequent consultation and information sharing is conducted therefore at regular intervals through both national and local procedures with representatives from Network Rail and trades unions.

Our equal opportunities policy is communicated to employees. We are committed to offering our employees a fulfilling and challenging career in an environment free from discrimination, harassment, victimisation and bullying. Network Rail continues to work with trades unions in the area of equality of opportunity and development of policy to promote best practice within the business.

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

Contributions for charitable and political purposes

During the year the Company donated £496,000 to charitable organisations (2005/06: £480,000). A further £477,000 (2005/06: £406,000) was used to sponsor charitable and community-related activities.

In line with the Company's policy, no donations to political parties were made in either year.

Under company law disclosure is required of particulars of any donations to any EU political organisation and EU political expenditure incurred. The definition of these types of donation is uncertain. On one strict interpretation the Company made payments during this year which may fall within the meaning of this type of donation. These payments form part of the work Network Rail does with community representatives such as elected representatives (Members of Parliament, Members of the Scottish Executive, Welsh Assembly and London Assembly, regional assemblies, local councils and others) as well as non-government organisations, pressure groups and campaigning organisations. This work includes meetings to discuss

issues facing the Company and those using the rail infrastructure, both passengers and freight customers nationally and regionally. Opportunity is also taken to explain the Business Plan, operational performance and significant developments within the business. These are sometimes best achieved through the Company organising briefings and similar functions at which presentations are given or attendance takes place at party political conferences and events.

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 2007 the Company's creditor days compared with the value of suppliers' invoices received in the year was 51 days (2005/06: 49).

Auditors

At the next Annual General Meeting of Network Rail Limited on 18 July 2007, a resolution will be proposed to reappoint Deloitte & Touche LLP as the Group's auditors and to authorise the Directors to fix their remuneration. Details of the fees earned by Deloitte & Touche LLP during the period, for both audit and non-audit work, are set out in Note 6 on page 49.

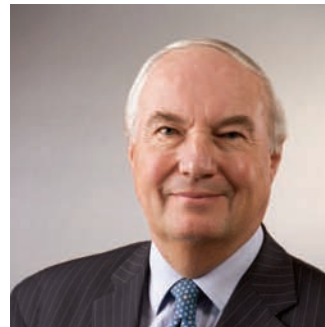
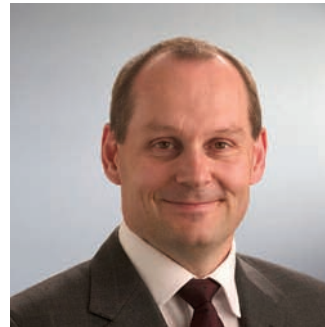
Pursuant to the Companies Act Section 234 ZA each of the Directors confirms that, so far as he or she is aware, there is no relevant audit information of which the Company's auditors are unaware and that he or she has taken all responsible steps in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

By order of the Board



Hazel Walker
Secretary
24 May 2007

Board of Directors



Ian McAllister CBE

Chairman (2, 4)*

Ian McAllister, 63, 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, a Director of the Energy Savings Trust, a Director of UCL Business plc and Senior Independent Non-Executive Director of Scottish & Newcastle plc. Ian is a member of the Institute of Chartered Accountants in England and Wales' Corporate Responsibility Advisory Group.

Ian Buchan

Non-Executive Director (2)*

Ian Buchan, 60, joined the Board in 2006 after retiring as Chief Executive of National Express's trains division. He was previously Business Development Director at FirstGroup. He is a director of Manchester School of Flying and serves on a number of committees at Manchester Airport. Originally an economics graduate, Ian has also been a school governor.

John Armitt CBE

Chief Executive (3, 5, 6)*

John Armitt, 61, is the Chief Executive of Network Rail. He will retire from this role in July 2007. A civil engineer by training, John had a 27 year career with John Laing Construction working on major projects in the UK and around the world, including: power stations, oil rigs, petrol-chemical plants, airports, roads, bridges and hospitals. He was Chief Executive of Costain Group PLC, and before that Chief Executive of Union Railways. He has recently been appointed Chair of the Engineering and Physical Sciences Council and from September 2007 will be Chair of the Olympic Development Authority.

Yvonne Constance OBE

Non-Executive Director (1, 2)*

Yvonne Constance, 64, joined the Board in 2005 having previously been Chairman of the National Electricity Consumers' Council between 1995 and 1999, a Non-Executive Director of Innogy plc from 2000 to 2002 and a Non-Executive Director of St Mary's Hospital NHS Trust. Until its cessation in 2005 she was also a member of the Greater London Magistrates' Courts' Authority, as well as being a Justice of the Peace since 1976 and, in the 1980s, practised as a barrister.

Iain Coucher

Deputy Chief Executive (3)*

Iain Coucher, 45, is Deputy Chief Executive with responsibility for operational matters and will take over from John Armitt as Chief Executive in July 2007. Previously, he was Chief Executive of Tube Lines. For 16 years, he worked for EDS. His career has included experience in the transportation sector, particularly with London Underground. He was seconded to the TranSys consortium between 1996 and 1998 as its Chief Executive and led the development of the Underground's smartcard ticketing system. Iain is an Engineering graduate from Imperial College, London and also has an MBA.

Michael Firth

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

Michael Firth, 64, joined the Board in 2004 having previously been Head of Corporate Banking at HSBC Bank plc until his retirement in September 2002. He is also a Non-Executive Director of Communis plc and Gartmore European Investment Trust plc. He was previously a Non-Executive Director of Somerfield plc and a director of First Technology PLC. Michael is an Associate of the Chartered Institute of Bankers.

Ron Henderson

Group Finance Director (3, 6)*

Ron Henderson, 61, was formerly Group Finance Director of BICC plc, Finance Director of Balfour Beatty, and most recently Chief Executive of Tuberaill, one of the bidders for the London Underground public private partnership. Prior to this, Ron, a Scottish Chartered Accountant was at Halliburton, Brown and Root and earlier with Arthur Andersen.

Christopher Green

Non-Executive Director (2, 5)*

Christopher Green, 63, joined the Board in 2005 following his retirement as Chairman of Virgin Rail Group. Chris has over 40 years of railway experience, having joined British Rail upon leaving university. He held various management positions including Managing Director of Network SouthEast and Intercity. He was Chief Executive of Virgin Trains from 1999 to 2004. Chris was also Chief Executive of English Heritage, a non-executive director of Eurotunnel and is a Trustee of the Liverpool Royal Philharmonic Orchestra.



Peter Henderson

Projects and Engineering Director (3)*

Peter Henderson, 53, is Network Rail's Projects and Engineering Director. Peter has over 20 years' rail experience, most recently at Bechtel where he was Projects Director, Rail, which included responsibility for engineering. He spent 16 years with the Hong Kong Mass Transit Railway Corporation, latterly as Head of Major Projects.

Charles Hoppe

Non-Executive Director (2, 5)*

Charles Hoppe, 72, joined the Board in 2002 and 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. Chuck has an MBA from Harvard Business School and was on the Advisory Board of the School of Civil Engineering at Purdue University and on the Board of Trustees of the National Railroad Library, University of Missouri (St. Louis). Charles will be retiring from the Board on 18 July 2007.

Jim Cornell

Non-Executive Director (2, 4, 5)*

Jim Cornell, 67, joined British Rail (BR) in 1959 as a student civil engineer before taking up various positions in BR including General Manager of Scotrail, Director of Civil Engineering and latterly Group Managing Director of British Rail Infrastructure Services between 1993 and 1996. He is also Executive Director of the Railway Heritage Trust. He was appointed the Senior Independent Non-Executive Director of Network Rail in January 2006.

David Bailey OBE

Non-Executive Director (1, 2, 4, 5)*

David Bailey, 67, joined the Board in August 2002. David has a procurement and logistics management background. He was formerly Commercial Director for London Transport, having previously held various director-level roles within London Underground. David is Chairman of Atlas-GOSS Limited and two charities, Home-Start North East Hampshire and Rushmoor Children and Young People's Partnership.

Rob den Besten

Non-Executive Director (1, 2)*

Rob den Besten, 66, joined the Board in 2003 having previously been President and Chief Executive Officer of Netherlands Railways, President and CEO of Amsterdam Airport Schiphol, Permanent Secretary of the Ministry of Transport and Public Works and Managing Director of the Rotterdam Municipal Transport Corporation. Rob is on the supervisory boards of a number of Dutch companies and is Chairman of the Board of Trustees of the Netherlands Maritime Museum in Amsterdam. Rob will be retiring from the Board on 30 June 2007.

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

- 1 Audit Committee
- 2 Remuneration Committee
- 3 Executive Committee
- 4 Nominations Committee
- 5 Safety, Health and Environment Committee
- 6 Treasury Committee

Directors' remuneration report

The following report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002 (the Regulations) and the Financial Reporting Council's Combined Code issued in June 2006.

The Remuneration Committee

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

Jim Cornell – Chairman of the Committee
David Bailey
Rob den Besten*
Ian Buchan
Yvonne Constance
Michael Firth
Christopher Green
Charles Hoppe**
Ian McAllister

* Retires on 30 June 2007

**Retires on 18 July 2007

The Group Company Secretary is the secretary to the Committee.

The Committee is required under its terms of reference to meet at least once a year and during the year 2006/07 it met five times.

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

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

During the year the Committee's activities included:

- finalising the MIP 2006/07;
- determining the incentive awards to be paid pursuant to the MIP 2005/06;
- preparing the MIP 2007/08; and
- reviewing the benchmarking of basic salaries.

The Committee commissioned New Bridge Street Consultants LLP to provide independent expert advice on the management incentive schemes and remuneration generally. New Bridge Street does not provide other services to Network Rail.

During 2006/07 Watson Wyatt Limited advised the Company in respect of pension related matters included in the remuneration policies.

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

Directors' remuneration policy

Network Rail has a network licence condition requirement to have a MIP for its Executive Directors and senior executives and for that plan to be cascaded throughout the Company.

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

- securing the operation and maintenance, renewal and replacement, improvement, enhancement and development of the network especially operational performance, asset serviceability and condition, efficiency, economy and safety;
- infringement by Network Rail of any access contracts and safety factors;
- achievement of the licence requirement of dealing with dependent persons with due efficiency and

economy and in a timely manner and compliance with Network Rail's Code of Practice for dealings with dependent persons; and

- the extent to which Network Rail is subject to orders and to statements by the Office of Rail Regulation (ORR) on non-compliance with the licence.

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

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

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

- provide strong incentives to deliver the actions and objectives specified in the Business Plan;
- identify specific accountability for the achievement of the actions and objectives laid out in the Business Plan;
- enable Network Rail to recruit, retain and motivate individuals with the right skills, knowledge, experience and competencies;
- draw on best practice for listed companies in the UK where appropriate given the unique mission and structure of Network Rail;
- recognise that Network Rail is accountable for the public interest as a monopoly owner and operator of an asset of considerable public importance;
- recognise that Network Rail Limited is a company limited by guarantee founded on a 'not-for-dividend' principle; and
- reflect the fact that the Company is unable to offer the traditional benefits of UK listed companies including stock options and other profit-share mechanisms.

These are structured within a total remuneration approach, defined as the sum of base salary, incentives and benefits. The use of variable pay through

the availability of incentives to form a significant part of total remuneration is intended to ensure that each individual's reward is clearly linked to the successful delivery of Company objectives.

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

Through the following means the Company sought transparency in respect of the principles upon which remuneration of the Directors of the Company has been set:

- publication in 2006 of a statement detailing the contents of the Executive Directors' MIP 2006/07 (pursuant to the terms of Network Rail's network licence);
- sharing of proposals for the MIP 2007/08 with members of Network Rail Limited at its Half Year Results meeting in November 2006 and invitation to members to comment on these both at that meeting or subsequently; and
- publication in May 2007 of a statement detailing the contents of the Executive Directors' MIP 2007/08 (pursuant to the terms of Network Rail's network licence).

Executive Directors' reward package

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

Base salary

This is a fixed cash sum payable over 13 periods during the financial year. The Committee reviews salaries annually as part of the total reward package recognising market levels and personal contribution. The aim is to ensure that

salaries are competitively set at broadly median levels in relation to similar roles in appropriate regulated companies and companies within the FTSE.

Current salaries for the Executive Directors, following the most recent salary review effective from 1 July 2006 are:

Executive Directors	Annual base salary as at 31 March 2007 £
John Armit	522,000
Iain Coucher	466,000
Peter Henderson	347,500
Ron Henderson	347,500

Incentive arrangements

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

MIP 2006/07 – annual incentive

As detailed in last year's Annual Report, the annual bonus for 2006/07 was to be calculated measuring actual Company performance against the three equally-weighted targets set in the MIP 2006/07. These were Reliability Index, Asset Stewardship Incentive Index (ASII) and Financial Efficiency Index (FEI). For each measure a target level and maximum level of achievement was set, with the maximum level representing at least the achievement of the 2007/08 Business Plan a year early. Achievement between the target level and maximum was calculated on a 'straight line' basis. For the year 2006/07, only the ASII achieved at least target level.

The following level of bonuses thus became payable under the terms of the MIP 2006/07:

- in respect of Reliability Index, the target figure was 1.319 with a maximum target of 1.369. The actual result was 1.218, producing no payment for this element;
- in respect of ASII the target was 0.78 with a maximum target of 0.75. The actual result was 0.72, producing a payment of 20 per cent of salary for this element; and
- in respect of FEI the target level of achievement was 1,877 with a maximum target of 1,770. As a result of the financial impact of the Cumbrian incident, the actual result was 1,904. Consequently no payment for this element has been made.

The resultant total potential award was 20 per cent of basic salary. In accordance with the terms of the MIP, the Committee then considered whether to use its discretion by reducing the overall bonus award for the Executive Directors having regard to Network Rail's safety performance, the extent to which the key objectives of the Business Plan over the performance period have been achieved and the requirements of Network Rail's network licence.

A further discretionary reduction to the potential award has been made. This decision by the Remuneration Committee took into account the overall performance of the Company during the year. The Committee was also mindful that the failure to meet the FEI target was due to the impact of the Cumbrian incident. In addition it took into account the many areas of performance, including safety, where there has continued to be significant improvement in the last year. In order to underline the importance of the Company's commitment to continuing focus on operational excellence, however, the Committee decided to exercise its right to reduce the award by a further 15 per cent.

Details of the resulting bonus payments awarded to each Director are detailed on page 28.

MIP 2007/08 – annual incentive

Participants under the MIP 2007/08 will be eligible to receive bonuses based again on demanding business performance measures and targets. The MIP 2007/08 uses key performance indicators (KPIs) based upon those contained in the Business Plan 2007 but in certain respects more stretching.

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

Business performance measures

The amount payable to Executive Directors will be calculated by reference to performance against the same output

measures to those used in the 2006/07 MIP.

Reliability (weight one-third) – this is the index established to measure improvements in train performance, comprising of separate elements for passenger reliability and freight reliability weighted according to their respective traffic volumes. It comprises both Train Delay Minutes and PPM (weighted two thirds/one-third). For Train Delay Minutes this is expressed as an index per 100 train kilometres, to ensure that the impact of the volume of trains is correctly reflected.

Financial Efficiency Index (weight one-third) – this is a measure of the efficiency of operating, maintenance and renewal expenditure, normalised to take account of changes in the volume of work required. The coverage of the FEI will be extended for 2007/08 to include switches and crossings renewals and major resignalling schemes. This will increase the coverage of the FEI from 60 per cent to 68 per cent of total operating, maintenance and renewals expenditure.

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

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

The structure of the MIP scheme for 2007/08 will be changed to incorporate the introduction of a taper principle. This change will allow significant performance to be recognised against a background of continued year on year stretch performance charges. The specific targets and taper trigger points are decided by the Remuneration

Committee, taking into account Regulatory Targets.

Payments under each of the three measures can only be made if performance meets or exceeds the trigger performance as determined by the Remuneration Committee in accordance with the taper principle. If target levels are achieved payments are calculated for above-target performance on a 'straight line' basis up to 'maximum' target level; the maximum incentive could be earned by achieving a level of performance at least equal to delivering one year early the 2008/09 performance on each measure as contained in the Business Plan 2007.

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

As a result of the annual remuneration benchmarking process, which is undertaken by external independent consultants, the potential annual incentive entitlement if all three measures achieve target level will be increased to 50 per cent. The maximum possible entitlement will also be increased to 100 per cent of salary, achievable only if all three measures hit maximum performance, by achieving a level of performance equal to or better than the 2008/09 performance described in the 2007 Business Plan.

Personal performance measures

There are no individual performance measures set for the Executive Directors. The Committee continues to believe that collective accountability of the Directors

necessitates a focus on collective performance incentives without individual performance measures. Other senior executives do have individual performance measures in addition to the business performance measures.

Long-term incentive (L-TIP)

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

As Network Rail Limited, being the ultimate parent of the Company, is a company limited by guarantee it is not possible to use traditional long-term incentives due to the absence of shares as the reward method. The L-TIP is based, therefore, on a deferred additional cash award in which awards are made after each three-year period triggered by relevant long-term improvement in business performance targets. The Remuneration Committee has designed this to incentivise the organisation to work together as a team and with external parties throughout the industry over the long term to achieve the key business objectives of the Company.

At the 2004 Annual General Meeting of Network Rail Limited its members approved the proposal by the Committee for a long-term incentive based on a deferred cash payment that reflect the Business Plan and the funding determined by the ORR's Access Charges Review 2003. The maximum amounts which could be earned under each three-year long-term incentive cycle are a cash sum equivalent to that earned under the previous year's annual incentive.

The second performance period for the long-term incentive ended on 31 March

2007 and payments under that L-TIP have been calculated, based on the two targets for the scheme.

L-TIP for three-year period 1 April 2004 to 31 March 2007

Public Performance Measure

Maximum Target	Minimum Target	Actual
86.6%	85.6%	88.1%

ORR cost reduction targets

Maximum Target	Minimum Target	Actual
£2,563m	£2,051m	£2,660m

Consequently payments were made in full to participants in this long-term plan, based on an amount equivalent to the annual incentive earned in 2004/05 (as described in previous years' remuneration reports).

Amounts paid to the four Executive Directors are the same as those published in the 2004/05 Annual Report as the maximum payable.

L-TIP for three years to 31 March 2007

Name	Amount earned
John Armitt	£112,320
Iain Coucher	£99,840
Peter Henderson	£74,880
Ron Henderson	£74,880

The maximum potential value of the long-term incentives receivable by each Executive Director at the end of the respective performance periods of the other three-year periods is as shown in the table below.

Performance measures

The two performance measures are:

Public performance: up to 31 March 2006 the Public Performance Measure was the most appropriate measure of network performance for inclusion in this long-term incentive, reflecting delays attributable both to Network Rail and the train operating companies. This measure is the percentage of passenger trains arriving on time over each twelve-month period as published in 'National Rail Trends'. 'On time' is defined as running as planned and arriving less than five minutes late at final destination or less than ten minutes late for inter-city operators.

Potential L-TIP awards (audited)

Director	Performance period		
	1 April 2004 to 31 March 2007 £	1 April 2005 to 31 March 2008 £	1 April 2006 to 31 March 2009 £
John Armitt	112,320	269,757	240,408
Iain Coucher	99,840	240,834	214,650
Peter Henderson	74,880	179,652	160,153
Ron Henderson	74,880	179,652	160,153
Total	361,920	869,895	775,364

These maximum sums will only be paid if the performance measures outlined on this page and page 26 are met in full.

With effect from 1 April 2006, it was decided, following consultation with the passenger and freight train operators, to introduce a modified target as the base of the measure for public performance. This new measure is the 'Public Performance Target', which also includes delays to freight trains, measured on a similar basis to passenger delays. Passenger and freight delays are therefore both included in this measure, weighted according to the number of train kilometres for each category of traffic. The target level of achievement for full payment to be made under this measure is a Public Performance Target (PPT) at the level included in the relevant Business Plan.

For the period from 1 April 2007 to 31 March 2010, the PPT target has yet to be confirmed, at the time of publication of this report, as this is subject to discussions with the ORR regarding Control Period 4.

Cost reduction: this measure reflects the cumulative cost reductions made in the three-year period. For full payment under the long-term incentive the target is achievement of a level related to the levels contained in the Business Plan 2006. No award under the long-term incentive will be payable unless at least 80 per cent of the cumulative savings set by the ORR are achieved.

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

L-TIP for three years from 1 April 2007

The maximum amounts payable under this element of the MIP are equivalent to the amount under the annual incentive for the year before the beginning of the long term plan. The maximum possible amount which could be earned each year as an L-TIP payment is capped at 100 per cent of the relevant participant's gross basic salary at the time of award.

The key change to the L-TIP 2007/08 from the previous L-TIP is that the provisional and conditional award for the three year period running from 2007/08 to 2009/10 is to be calculated on the

basis of the average of the awards made in each year of the three year performance period.

Members will be asked to approve the L-TIP at the Annual General Meeting of Network Rail Limited in July 2007.

Regulatory MIP statement

As required under the network licence of Network Rail, a statement will be published in May 2007 detailing the contents of the Executive Directors' MIP 2007/08.

Pensions

Executive Directors are entitled to pensions based on salary and length of service with a maximum pension of two-thirds of final base salary. Details are set out on page 29.

Directors' service terms Executive Directors

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

At the time of drawing up the service agreements the Committee took into consideration the UK Listing Authority's corporate governance code and the recommendations contained within the joint statement of the Association of British Insurers and the National Association of Pension Funds published in December 2002 on best practice on executive contracts and severance. These were applied as far as practicable and appropriate having regard to the nature of the business and the corporate structure of the Company and then current practice. With the forthcoming retirement of John Armit in July 2007 and Iain Coucher's subsequent appointment to the role of Chief Executive at that time, the opportunity has been taken to review Iain Coucher's service agreement against current best practice and again so far as practicable and appropriate this has been adopted.

All the Executive Directors' service agreements provide for notice periods of no greater than one year, to reflect current corporate governance best

practice. Executive Directors are required to give not less than six months' notice if they wish to leave.

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

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

Executive Directors	Effective date of contract
John Armitt*	3 October 2002
Iain Coucher	3 October 2002
Peter Henderson	3 October 2002
Ron Henderson	3 October 2002

* John Armitt had previously a contract of appointment dated 14 December 2001.

Non-Executive Directors

Non-Executive Directors are appointed by the Board on the recommendation of the Nominations Committee. Their appointment is for an initial term of three years, subject to election by the members of Network Rail Limited at the first AGM following their appointment. They do not have service agreements. Instead the terms of their engagement are set out in a letter of appointment and their appointments may be terminated at any time on six months' notice without compensation. Further, as mentioned above, the letter of appointment of the Chairman also contains provisions for termination of his appointment without compensation upon the occurrence of certain significant financial failures of the Group unless a majority of the Board of the Company and the DfT (in its role as provider of credit facilities) decide that these appointments should not be terminated.

Non-Executive Directors	Effective date of original contract
Ian McAllister	3 October 2002
David Bailey*	15 August 2002
Rob den Besten**	24 September 2003
Ian Buchan	5 February 2006
Yvonne Constance	1 May 2005
Jim Cornell***	3 October 2002
Michael Firth	4 December 2004
Christopher Green	26 June 2005
Charles Hoppe****	3 October 2002

* David Bailey's appointment in 2002 was as Special Director; upon conversion of his appointment a new letter of appointment was issued in 2005.

** Rob den Besten retires on 30 June 2007.

*** Jim Cornell had previously an appointment letter dated 14 December 2001.

**** Charles Hoppe retires on 18 July 2007.

External appointments

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

None of the Executive Directors currently holds a Non-Executive Director position with a listed company.

Non-Executive Directors' remuneration

The Non-Executive Directors of the Company are also the Non-Executive Directors of Network Rail Limited but their letters of appointment are with this Company covering both positions. No other contractual provisions or remuneration arrangements exist in relation to their directorships (if any) of any other company within the Network Rail Group. For the purpose of this Directors' Remuneration Report and the Directors' Remuneration Report for Network Rail Limited, therefore, the following provisions of this report also appear in the Annual Report of that company. The letters of appointment are available for inspection at the Company's registered office.

Non-Executive Directors do not receive any benefits from the Company other than a fee together with their reasonable expenses for attending meetings of the Board and other meetings and events.

Current annual fees for the Non-Executive Directors are:

Non-Executive Director	Fee £
David Bailey	42,000
Rob den Besten	42,000
Ian Buchan	42,000
Yvonne Constance	42,000
Jim Cornell*	63,000
Michael Firth**	57,000
Christopher Green	42,000
Charles Hoppe	42,000
Ian McAllister	250,000

* Includes additional fees paid for his chairmanship of Board committees and membership of Membership Selection Panel.

** Includes additional fees paid for his chairmanship of Board committees.

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

Safety Health & Environment Committee
Audit Committee
Remuneration Committee
Treasury Committee

With the exception of the fee for the Chairman (which is determined by the Remuneration Committee), the fees of the Non-Executive Directors are agreed by the Executive Directors of the Board. These fees are designed to recognise the significant responsibilities of Non-Executive Directors and to attract individuals with the necessary high quality experience and ability to make an important contribution to the Company's business.

Disclosure of Directors' remuneration for 2006/07

Name	Notes	Salaries and fees £000	Bonuses Annual £000	L-TIP and AVC payments by the Company £000	Supple- mentary/ Company pension contributions/ AVC payments £000	Benefits (including pension allowances and life cover) £000	2006/07 Total £000
John Armitt		517	89*	112	154	16	888
David Bailey		40					40
Rob den Besten		40					40
Ian Buchan		40					40
Yvonne Constance		40					40
Jim Cornell	1	60					60
Iain Coucher		461	79*	100	133	36	809
Michael Firth	2	53					53
Christopher Green		40					40
Peter Henderson		344	59*	75	98	15	591
Ron Henderson		344	59*	75		100	578
Charles Hoppe		40					40
Ian McAllister		236					236

Notes

1 Includes additional fees paid for his chairmanship of Board committees and membership of Membership Selection Panel.

2 Includes additional fees paid for his chairmanship of Board committees.

* Based upon formal annual award – on 24 May the Executive Directors announced their decision to defer this award until the causes of the Grayrigg derailment are fully understood.

Directors' remuneration comparison: 2006/07 against 2005/06

	Notes	2006/07 Total £000	2005/06 Total £000
Current Directors			
John Armitt		888*	1,027
David Bailey		40	39
Rob den Besten		40	37
Ian Buchan		40	4
Yvonne Constance		40	33
Jim Cornell		60	54
Iain Coucher		809*	924
Michael Firth		53	38
Christopher Green		40	29
Peter Henderson		591*	678
Ron Henderson		578*	683
Charles Hoppe		40	37
Ian McAllister		236	210
Past Directors			
Ross Sayers	1	–	35
Total		3,455*	3,828

Notes

1 Died on 25 November 2005.

* Based upon formal annual award – on 24 May the Executive Directors announced their decision to defer the annual bonus award element included in this figure until the causes of the Grayrigg derailment are fully understood.

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 March 2006 £ (C)	Transfer value of accrued RPS pension at 31 March 2006 £ (D)	Transfer value of accrued RPS pension at 31 March 2007 £ (E)	Total change in transfer value during period £ (F)	Value of net increase in accrual over period £ (G)
John Armitt	2,024	1,662	9,571	160,364	192,657	22,567	23,733
Iain Coucher	1,984	1,690	8,113	68,505	102,443	24,212	11,613
Peter Henderson	1,984	1,690	8,113	97,581	143,490	36,182	20,163
Ron Henderson	1,993	1,684	8,425	136,698	169,641	23,217	24,181

Notes

1 Pension accruals shown are the amounts which would be paid annually on retirement (or earlier leaving) based on service to the end of the year.

2 Transfer values as at 31 March 2006 (D) and 31 March 2007 (E) have been calculated in accordance with version 8.1 of guidance note GN11 issued by the actuarial profession.

3 The change in the transfer value (F) includes the effects of fluctuations in the transfer value due to factors beyond the control of the Company and Directors, such as stock market movements. It is calculated after deducting the Director's contribution.

4 The value of net increase (G) represents the incremental value to the Director of their service during the year, calculated on the assumption that service terminated at the year end. It is based on the accrued pension increase (B) after deducting the Director's contribution.

Directors' emoluments (audited)

The fees, which are neither performance related nor pensionable, are benchmarked and periodically reviewed against, and are in line with, those paid by other comparable private sector companies taking into account time commitment and competition for similar positions in other companies.

The total amount of Directors' emoluments for services provided solely to the Company during the year was £3,455,000* (2005/06: £3,828,000).

* Based upon formal annual award – on 24 May the Executive Directors announced their decision to defer the annual bonus award element included in this figure until the causes of the Grayrigg derailment are fully understood.

Directors' pensions (audited)

The table below shows the pension entitlement from the Network Rail section of the Railways Pension Scheme (RPS), and additional defined contribution arrangements of each Executive Director of the Company during the year ended 31 March 2007, together with the increases in those benefits during the year, calculated using the accrued benefit basis.

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

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

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

The following sections describe the pension benefits received by Executive Directors in 2006/07:

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

In addition to members' benefits, dependants' pensions are payable after the death of the member, in line with

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

Additional pension benefits

Current Directors	Company contributions to additional pension provision whilst a Director during the year £ (H)	Company payments to additional pension provision* in respect of prior year £ (I)	Matching Company additional voluntary contributions whilst a Director during the year £ (J)
John Armit	149,537	144,526	4,844
Iain Coucher	133,008	128,473	–
Peter Henderson	97,821	94,510	–
Ron Henderson	–	94,510	–

Notes

- 1 The current Directors were Directors for the whole year.
 - 2 Ron Henderson elected to receive an equivalent additional allowance in 2006/07 in lieu of additional pension contributions. This payment is included in the benefit figure reported on page 28.
 - 3 The contributions in respect of previous years are not included in column (H).
 - 4 None of the Non-Executive Directors is a member of the Network Rail section of the RPS and Non-Executive Directors have no other pension entitlements.
- * Provided through Funded Unapproved Retirement Benefit Schemes in prior year.

Additional pension benefits

As described above, some Directors are entitled to additional pension benefits in which case the Director could choose the extent to which the gross payment was made to the pension arrangement, or taken as cash. Future contributions are at a pre-determined level, and the amount has been notified to each Director. The contributions made during the year together, where appropriate, with contributions in respect of benefits accrued prior to the year under review are shown on page 30.

The RPS also operates a matching additional voluntary contribution facility, whereby voluntary contributions paid by members are matched by equivalent payments from the Company, up to certain limits. These matching arrangements were 'frozen' for all members of the Network Rail section of the RPS at the levels applicable on 6 November 2003, and this limit was applied to Directors as to other members. Matching payments made in 2006/07 are also shown on page 30.

During 2005, the Company reviewed all its current pension arrangements as a consequence of the Government's Tax Simplification changes ('A Day') that took effect from 6 April 2006.

The Company modified its pension arrangements where appropriate from 6 April 2006 following the wide ranging revision of tax laws applying to pension schemes introduced by the Finance Act 2004. As indicated in last year's report, the Company's policy on this issue was that the changes should have no incremental cost impact to the Company. A number of changes were made at that time to the Company pension arrangements, which apply to all employees, including Executive Directors. The key changes are as follows:

- although the Government Earnings Cap no longer exists, the Network Rail Section of the RPS will continue to limit pensionable salaries to the level of the previous Earnings Cap (increased according to the same annual increase formula as was previously applied);

- from 6 April 2006 members are permitted to pay more than 15 per cent into pensions, though the excess above the previous limit to member's contributions of 15 per cent of salary can only be contributed into the Network Rail Defined Contribution Scheme or to a personal pension (not into the RPS BRASS arrangements);
- from 6 April 2010 a minimum early retirement age of 55 has been introduced for new RPS members after 5 April 2006;
- members over age 55 are able to draw their pension whilst remaining in employment with company consent – though such early retirement would be on cost neutral early retirement factors rather than the beneficial ones applying under the RPS; and
- members are able to take up to 25 per cent of their pension as a cash sum.

Also in relation to the Executive Directors, contributions made by the Company into Funded Unapproved Retirement Benefits Schemes (FURBS) ceased from 6 April 2006. Instead an equivalent amount will be paid on the Director's behalf into the Network Rail Defined Contribution Scheme (NRDCS); alternatively they may elect to receive a cash payment at no greater cost to the Company. Life Assurance for directors whose pensionable salary is restricted by the notional Earnings Cap mentioned above will be provided through the NRDCS.

Performance graph

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

Directors' interests

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

On behalf of the Remuneration Committee



Jim Cornell

Chairman, Remuneration Committee
24 May 2007

Corporate governance report

Corporate governance principles

The Board considers that good corporate governance is central to achieving the Company's objectives and to the principle of safeguarding stakeholders' interests in the rail infrastructure. The Company is committed to high standards of business behaviour and has an established governance framework which comprises an organisational structure, internal control systems and business conduct policies. These form the framework for effective decision-making and delivery of the quality rail infrastructure this country needs.

It is also a condition of Network Rail'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 (as amended with effect on 1 June 2006) (the Code). The Code includes a requirement for companies to make statements on corporate governance in their annual reports.

Having reviewed the requirements of the Code, the Directors consider that Network Rail has complied throughout the financial year ended 31 March 2007 with the provisions set out in Section 1 of the Code. This Corporate Governance Report, coupled with the Directors' Remuneration Report, explains how the Company has applied the governance principles set out in the Code. Details of the Company's internal controls are set out on pages 38 to 39.

Board of Directors

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

The information on pages 20 and 21 shows that at the date of this report the Company is led and controlled by a board currently comprising four Executive and nine Non-Executive Directors. Following the forthcoming retirement of the current Chief Executive, John Armit, and appointment of Iain

Coucher (currently Deputy Chief Executive) as his successor with effect on 1 August 2007, there will be three Executive Directors. The number of Non-Executive Directors will also reduce to seven with the retirement of Rob den Besten on 30 June 2007 and Charles Hoppe following the AGM on 18 July 2007. Notwithstanding these changes, collectively, the Board believes it continues to possess wide experience both within the rail industry and generally as well as the necessary range of qualities, skills and experience to lead the Company effectively. It also believes the size of Board to be appropriate in view of the nature of the Group's business and the issues facing it.

Directors are appointed by the Board and are also the Directors of Network Rail Limited. Under the provisions of the Articles of Association of the Company the Directors are not subject to retirement by rotation due to it being a wholly-owned subsidiary of Network Rail Limited. Under the provisions of the Articles of Association of Network Rail Limited, however, all Directors (other than the Special Director – see below) must retire by rotation, and may stand (together with any new Director appointed since the last general meeting) for re-election by the Members of the Company at least once every three years. No new Directors have been appointed since the AGM in 2006. The names of the Directors due to stand for re-election at Network Rail Limited's Annual General Meeting (AGM) in July 2007 are set out on page 18 of the Directors' Report and further information will be given in the documents accompanying the Notice of the AGM to be sent to members of Network Rail Limited.

The Board's responsibilities

Certain matters are formally reserved for decision by the Board and its duly authorised committees. These include approval of:

- the Group's overall strategy and annual operating budget;
- the interim and year-end financial statements of the Company;
- the Business Plan;
- material changes to the network licence;
- key pension matters;
- appointments to the Board;
- adequacy of internal control systems

- major capital investments and expenditure; and
- review of the performance of the Board and its committees.

Matters delegated to Executive Committee or below are also subject to financial limits above which Board approval is required.

The Roles of the Chairman and Chief Executive

The responsibilities of the non-executive Chairman include leading the Board and ensuring its effectiveness. He sets the agenda for the meetings of the Board and, with the assistance of the Group Company Secretary, arranges for the Directors to receive timely, accurate and clear information before Board meetings and updates on issues arising between meetings. The Chief Executive is responsible for leading and managing the business on a day-to-day basis within the authorities delegated by the Board and is accountable to the Board for the financial and operational performance of the Group.

The roles of the Chairman and the Chief Executive are distinct and separate and their responsibilities are clearly established being set out in writing and having been agreed by the Board. The Chairman is responsible for the workings and leadership of the Board.

Non-Executive Directors and their independence

The Non-Executive Directors combine broad business and commercial experience (both from the rail industry and from other industry sectors) to enable them to challenge and contribute constructively to the development of the strategy of the Group. They also scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance.

The current Senior Independent Director is Jim Cornell. He is available to Members as an additional point of contact to the Chairman and the Chief Executive.

The Board considers that each of the Non-Executive Directors is independent of the Company. With regards to the guidelines on the meaning of

‘independence’ as set out in the Code, however, it is appropriate to disclose that:

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

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 Group. This enables him to challenge constructively and effectively operational matters within the Group as well as participating in the full range of responsibilities of a Non-Executive Director.

2 David Bailey was previously the Special Director appointed to the Board of Network Rail Limited by the Strategic Rail Authority (SRA) pursuant to its then rights under the Articles of Association of that company. Following the changes under the Railways Act 2005 with the responsibilities of the SRA passing principally to the Department for Transport (DfT), the DfT has not exercised its right to appoint a Special Director.

The Board considered that David Bailey makes a valuable contribution to the Company in his non-executive director role. His wide ranging commercial experience has enabled him to provide additional perspective on issues and the Company wished to retain him as it moves into its new roles. At the AGM of Network Rail Limited in 2005 his appointment as a Non-Executive Director was approved.

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, Remuneration, Audit and Safety, Health and Environment Committees. Upon the conversion of his appointment in June 2005 to Non-Executive Director, he has continued to be a member of these committees due to the valuable contribution he is able to make.

Board meetings

The Board met ten times in 2006/07. There is a schedule of items to be brought to the Board throughout the year and a format for each meeting is prepared and agreed which enables the Directors to review corporate strategy regularly together with the operations and results of the business units within the Group and to discharge their other duties. Each meeting includes reports on the safety, health and environmental performance of the Group as well as on operational and financial performance against the Business Plan and targets. There are also periodical risk management reviews of the key strategic risks to the Group and the Board receives regular presentations from senior management.

Upon acquisition of the business in 2002 the demands on the Board's management skills in the early days focused on the need for significant overview of immediate day to day management. As the Company has developed the demands on the Board have moved to high level management of the overall strategic development of the business for the future. Following the annual review of the workings of the Board and its committees in February 2007, therefore, the Board has concluded that the number of scheduled meetings and the format of its meetings will be adjusted accordingly to reflect the maturing state of Network Rail's business. With effect from late 2007 the Board will have eight scheduled Board meetings each year and the format of these meetings will enable even greater focus on and opportunity to debate future strategic issues facing the rail industry in addition to review of current performance of the business.

Annually the Chairman holds at least one meeting with the Non-Executive Directors without the Executive Directors present to discuss the performance of the Company under the executive leadership. Further, one meeting of the Non-Executive Directors chaired by the Senior Independent Director is held without the Chairman present.

A table detailing the individual Directors' attendance at each of the Board and committee meetings is set out on page 37.

Organisational structure

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

The composition of each committee is designed to maximise the range of skills and experience of Board members with the aim of not placing undue reliance on any one individual. Each committee may request any information from the executive management necessary to discharge its functions and may, if it considers necessary, seek independent advice and counsel.

As mentioned above, upon the retirement of John Armitt as Chief Executive in July this year and the appointment of Iain Coucher as his successor, the number of Executive Directors will reduce to three. In addition a number of changes will be made to the senior organisational structure of the Company, including certain reporting lines to the three Executive Directors and the composition of the Executive Committee.

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

The Safety, Health and Environment Committee

Composition This Committee comprises four Non-Executive Directors and the Chief Executive and is chaired by Jim Cornell. The Chief Executive and Deputy Chief Executive regularly attend the meetings together with the Director, Safety & Compliance.

Role The Committee's role is to monitor the integrity of the methods of discharge of the safety, health and environmental responsibilities of the Company and to satisfy itself as to the adequacy and effectiveness of the safety, health and environment policies and strategies within the Company. It also reviews the principles, policies and practices adopted in complying with all statutory, sub-statutory, standards and regulatory requirements in respect of safety, health and environmental matters affecting the activities of the Group.

Process The Committee conducts its responsibilities through a series of scheduled meetings with forward agendas set each year to meet the responsibilities on the Committee. The Committee chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting. Its work in fulfilling its responsibilities includes:

- monitoring of the Group's safety, health and environment policies and strategies;
- considering the areas of significant corporate and individual safety, health and environment risk and whether management is managing these effectively;
- reviewing the structure, adequacy and effectiveness of safety, health and environment managerial committees within the Company including review of any terms of reference for the same;
- reviewing the scope and results of any safety, health and environment audit on the effectiveness of the Company's safety, health and environment audit policies and strategies and such audit's cost effectiveness and the independence and the objectivity of the audit body; and
- considering the major findings of internal and external investigations

and management's response thereto and, where necessary, with a view to the making of recommendations to the Board in respect of the same.

In addition to this Committee, and reflecting the recommendations in the Cullen Report, two executive committees have been set up, dealing with strategic and tactical safety matters. Moreover, the Board receives a report on safety, health and environment matters at each of its scheduled meetings.

Activities in 2006/07 During the year ended 31 March 2007, the principal activities of the Committee included review of the following:

- selected key operational safety risks;
- progress with the implementation of action plan SAF 5 – Safety in the Line;
- key findings in annual regulatory safety reports;
- the impact of new safety related regulations;
- the terms of reference of the Strategic Safety Group and Tactical Safety Group;
- the status of implementation of new incident investigation responsibilities for the Railway Accident Investigation Board;
- the status of inquiries' recommendations;
- the rail strategic safety plan for 2007;
- the supplier and contractor accreditation and assurance processes;
- the implementation of new safety competencies assessment and monitoring; and
- the Committee's annual performance evaluation.

The Audit Committee

Composition This Committee is comprised of four Non-Executive Directors and is chaired by Michael Firth who has a financial background and experience at chairing a listed company's audit committee. The Chief Executive, the Group Finance Director, the Group Financial Controller and the Head of Internal Audit normally attend meetings of the Committee. The lead partner as well as the audit partner from the external auditors also attend each of the Audit Committee's meeting and periodically meet with the Committee without executive management present. The Board continues to be satisfied that the composition of the Committee fulfils the

Code's requirement that at least one member of the Committee has recent and relevant financial experience. It also considers that it complies with the Smith Guidance on Audit Committees in all material respects.

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

- reviewing the internal control framework and the register of financial and non-financial risks (so far as these are not reviewed by other Board committees such as the Safety, Health and Environment Committee);
- monitoring financial reporting practices including considering accounting policies and practices and compliance with accounting standards;
- reviewing significant accounting estimates and judgements;
- reviewing interim and annual financial statements before publication;
- considering and making recommendations to the Board in relation to the appointment, re-appointment and removal of the external auditors following its assessment of their independence and objectivity (including the safeguards that are in place to maintain such independence) and their terms of engagement and remuneration;
- reviewing the internal and external audit process including the scope of its planned audit and subsequently its audit findings; and
- reviewing the policy and procedure whereby employees can raise, in confidence, concerns about possible improprieties.

Process The Committee conducts its responsibilities through use of a series of scheduled meetings with a defined set of items of business for each meeting. The Committee chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting. Between meetings, the Committee chairman reviews

emerging issues as appropriate with the Group Finance Director and other senior managers.

Activities in 2006/07 During the year ended 31 March 2007, the principal activities of the Audit Committee included consideration of the following:

- interim and full year financial results;
- the 2006/07 internal audit plan and resources required;
- quarterly internal control reports from the internal audit function;
- the effectiveness of the internal audit function;
- the effectiveness of the external audit process;
- the independence and objectivity of the external auditors;
- the 2007 external audit plan and associated audit fees;
- the Company's internal control framework including the risk management process and progress on the management of the key risks identified by the Company;
- the status of employee concerns reporting/whistle-blowing;
- the Annual Report disclosure items relevant to the Audit Committee; and
- the Committee's annual performance evaluation.

During 2006/07 the Committee members also received separate briefings from the Group Financial Controller and the Company's Tax Manager on regulatory accounting and tax issues respectively.

External Auditors Independence and objectivity of the external auditors is of great importance to the Committee. A policy is in place to assist this whereby employment of the external auditors on work for Network Rail other than audit services or tax consulting services is prohibited without prior approval by the Audit Committee. A new lead partner is appointed every five years, with other key audit principals rotating every seven years.

The Committee has responsibility for advising the Board on the appointment, re-appointment and the remuneration of the external auditors. Deloitte & Touche LLP (Deloitte) has been the Company's external auditors since 2002 (and prior to that to Railtrack plc since 1996). During 2005 the Audit Committee asked the Group Company Secretary to carry out an assessment of the effectiveness of

Deloitte. A lengthy questionnaire was completed by the external auditors detailing their procedures, training and audit processes as well as how independence and objectivity is maintained. Consultation within the Company as to the performance of the external auditors was also carried out. As a result of the assessment, the Committee recommended in 2005 that a resolution to re-appoint Deloitte be proposed at the 2005 AGM which was passed.

This year, after reviewing the independence of Deloitte, the audit engagement terms and proposed fees, the Audit Committee has recommended to the Board that at the AGM in July 2007 it proposes the re-appointment of Deloitte as auditors until the conclusion of the AGM in 2008.

The Remuneration Committee

This Committee comprises all of the Company's Non-Executive Directors and is chaired by Jim Cornell. It determines appropriate levels of Directors' and senior executives' remuneration including their incentive scheme. The Committee's report is contained in pages 22 to 31.

The Nominations Committee

Composition This Committee is chaired by Ian McAllister as the Chairman of the Board and comprises two further Non-Executive Directors.

Role The role of the Committee includes:

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

Process The Committee conducts its responsibilities through meetings held as appropriate. The Committee chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting. Between meetings, the Committee chairman discusses matters of succession and recruitment with the other members of the Committee on an ad hoc basis as required.

Activities in 2006/07 During the financial year 2006/07 the Nominations Committee has met twice to consider performance evaluation of the Board, its committees and Directors, succession planning, organisational structure, the appointment of a new Chief Executive and possible candidates for appointment as Non-Executive Directors of the Company. This process included consideration of the experience and skills sought for the role and commissioning Egon Zehnder International to conduct various searches for suitable candidates.

More generally for succession purposes the Company reviews internal executive skills regularly including through the use of a 'talent pool' that uses assessment testing and other data to identify suitable candidates for succession opportunities. Individuals identified with senior management potential also attend focused leadership development training at the Company's own centre which provides courses in collaboration with Warwick Business School (a part of Warwick University).

The Treasury Committee

Composition This Committee comprises three directors, with Michael Firth as chairman. The Director of Funding and other senior funding managers attend the meetings.

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

Process The Committee conducts its responsibilities through a series of scheduled meetings. The Committee chairman reports on the Committee's activities to the Board meeting immediately following a Committee meeting. Between meetings, the Group

Finance Director updates and discusses with the Committee chairman matters relating to the treasury activities.

Activities in 2006/07 During the year ended 31 March 2007, the Committee met twice and its principal activities included consideration or review of the following in relation to the various funding arrangements for the Group:

- the Debt Issuance Programme;
- the Commercial Paper Programme migration to Network Rail Infrastructure Finance PLC;
- the interest rate hedging controls;
- risk capital options;
- cash management;
- treasury policy and activities;
- debt maturity profile;
- investor relations activity; and
- the Committee's annual performance evaluation.

At executive level in the Company there is the **Executive Committee** chaired by the Chief Executive, currently John Armit (with Iain Coucher to succeed with effect on 1 August 2007), and comprising all the Executive Directors and a number of senior executives. The composition of the senior executives has been reviewed recently and with effect from September 2007 this will be revised with the inclusion of a number of other senior managers. This Committee manages the functions of the business and implements the operational and financial objectives within limits set by the Board. Additionally there is a defined structure of other executive steering groups and panels with clear terms of responsibilities focusing on specified aspects of the operational needs of the business with prescribed levels of authority.

The table on page 37 identifies the number of meetings of the Board, the five main Board committees, the Executive Committee held between 1 April 2006 and 31 March 2007 and the attendance record of individual Directors.

There may be occasions when circumstances arise which prevent a Director from attending a meeting in person. It is usual practice in these circumstances for the Director concerned to review the papers and convey any views to the chairman of the meeting in advance.

Information about the Directors' remuneration is given in the Directors' Remuneration Report on pages 22 to 31 of this Report and details of how the Board reviews financial and operational controls and risk management generally are shown on pages 38 to 39.

Board effectiveness Induction and development

There is a comprehensive programme of induction for new Directors aimed at ensuring that they are fully conversant with their responsibilities as a Director and with the business of Network Rail. This includes provision of a comprehensive manual of key documents and background information relating to the Company and the industry, guidance on Board procedures and corporate governance matters. Thorough briefings on their responsibilities are given and site visits and one-to-one meetings with each of the Executive Directors, key senior managers and key stakeholders are also held.

Directors are then encouraged to update their skills, knowledge and familiarity with the Group through their on-going participation at Board and committee meetings, and through regular occasions for them to meet senior managers, other employees and Members as well as through site visits to operational locations.

Ongoing professional development is provided to Directors each year. During the past 12 months the Directors received briefings on relevant issues including new legislative developments relating to corporate governance reporting requirements and best practice and regulatory matters. Additional personal development is also available to all Directors.

Board evaluation review

The Nominations Committee is charged by the Board to review annually the performance of the Board, its principal committees and individual Directors. This is achieved through a formal process whereby guidelines to areas of focus have been drawn up with the assistance of external consultants. These guidelines form the basis for the evaluation process. Each review focuses on matters such as company strategy, performance, delegation and accountability, corporate responsibility, succession, relationships

	Board	Safety, Health and Environment Committee	Nominations Committee	Remuneration Committee	Audit Committee	Executive Committee	Treasury Committee
Number of meetings held	10	7	2	6	4	11	2
Directors							
John Armitt	10	6	–	6*	3*	11	2
David Bailey	10	7	2	6	4	–	–
Ian Buchan	10	–	–	6	–	–	–
Yvonne Constance	10	–	–	6	4	–	–
Jim Cornell	9	7	2	6	–	–	–
Iain Coucher	10	6*	–	–	–	11	–
Rob den Besten	9	–	–	5	4	–	–
Michael Firth	10	–	–	6	4	–	2
Christopher Green	10	7	–	6	–	–	–
Peter Henderson	10	–	–	–	–	11	–
Ron Henderson	10	–	–	–	4*	11	2
Charles Hoppe	9	6	–	5	–	–	–
Ian McAllister	10	–	2	6	–	–	–

* As attendee.

with stakeholders, Board and committee composition, Board communication and the contribution and effectiveness of individual Directors. The findings of the review of the Board are considered and discussed by the Board. The review of individual Directors is considered by the Chairman of the Board and where appropriate each Director receives personal feedback.

The policy adopted by the Nominations Committee is for external assistance also to be provided in conducting the review on a bi-annual basis. In the interim year the review is to be conducted internally by the Group Company Secretary. Separate meetings are held with each of the Directors.

In line with this policy, consultants, Egon Zehnder International, were engaged in both 2003/04 and 2005/06 to assist with the process. The 2004/05 review was conducted internally as was the review for 2006/07.

The latest review has led the Board to conclude that whilst it and its committees continue to operate effectively and (as mentioned above in this report) benefit would be gained from making some changes to the Board meetings. From acquisition of the business in 2002 the

demands on the Board's management skills have developed from in the early days the need for significant overview of immediate day-to-day management to its current requirements for overall strategic development of the business for the future. The Board has concluded that the number of scheduled meetings and the format of its meetings will be adjusted accordingly. With effect from later in 2007 the Board will have eight scheduled Board meetings each year and the format of these meetings will enable even greater focus on, and opportunity to debate, future strategic issues facing the rail industry in addition to review of current performance of the business.

The Nominations Committee has also concluded that each Director is continuing to contribute to the overall effectiveness and success of the Company and that each of the Directors who are proposed for re-election at the AGM in July 2007 continue to demonstrate the necessary commitment to the Company and to be fully effective members of the Board.

Company Secretary

The Group Company Secretary is the secretary to the Board and all of the above Board committees and is responsible for advising each of these, through their chairman, on all

governance matters. All Directors have access to the Group Company Secretary for advice on corporate governance, Board procedure and compliance matters. As well as supporting the Chairman with his responsibility for management of the Board and Board matters, the Group Company Secretary is also responsible for facilitating the induction and professional development of Board members and ensuring good flow of information within the Board, its Committees and between the Non-Executive Directors and senior management. The appointment and removal of the Group Company Secretary is a matter for the Board as a whole.

Advice

There is a procedure whereby Directors, wishing to do so in furtherance of their duties, may take independent professional advice at Network Rail's expense.

Relations with Members and stakeholders

The Board of Network Rail Limited is extremely committed to, and recognises the importance of, developing and maintaining an ongoing relationship based on regular communication and dialogue with its wide range of stakeholders.

Members

A variety of forms of contact with Members of Network Rail is used to help them hold the Board to account for the performance of the Group and to help the Members be aware of and understand developments within the business. Opportunities are also arranged on a frequent basis to enable discussion by the Members to take place. The various forms of communication include:

- publication of full Annual Reports and Accounts;
- publication of Interim and Preliminary Results;
- Annual General Meeting and other general meetings of Network Rail Limited as required;
- supply of key press releases, business documents and other material;
- copies of the Company's staff magazine;
- meetings with Directors and senior Network Rail staff;
- periodical local briefings and site visits;

- regular presentations on key issues;
- copies of documents published by other bodies e.g. ORR's quarterly monitor on Network Rail, key ORR consultation documents and other reports;
- the services of a staff member dedicated to responding to enquiries and issues raised by Members; and
- information contained on the Company's website – www.networkrail.co.uk.

Network Rail's website is updated frequently with announcements, the Business Plan, the Annual Report and Accounts, the Management Incentive Plan statement and other documents and information. Members of Network Rail Limited also have their own internet site.

Members have the opportunity to meet the Board both before and after the formal general meetings as well as to ask questions at the AGM (including by submission of written questions in advance). Before the AGM Members are encouraged to request areas of the business on which they would like presentations.

In advance of each AGM, Members are also invited to a meeting at which the ORR, the rail industry's regulating body, presents the ORR's views on the current performance of Network Rail against its regulatory obligations. With members of the Network Rail Board in attendance, Members are then able to question the ORR and the Company.

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

The next AGM will be held on 18 July 2007.

Other stakeholders

The Company also recognises the importance of good relationships with its wider stakeholder base especially its customers – the passenger and freight train operators, its suppliers, funders and its own employees. Emphasis is placed, therefore, on developing existing relationships as well as expanding the breadth of relationships. This includes the Chief Executive, the Deputy Chief Executive and the other Executive Directors having regular meetings with representatives of the ORR (as both economic and safety regulator), passenger and freight train operators and other rail stakeholders. Independent relationship surveys are conducted regularly with each of the Company's customers (the train operators), passengers, suppliers and its employees (using an employee engagement survey – see page 18 of the Directors' Report for more detail).

Corporate Responsibility

Corporate responsibility is also an important aspect of the role of Network Rail which the Company takes seriously. A report on its corporate responsibility priorities and activities during the year will again be published in 2007. There is also a Corporate Responsibility Committee chaired by the Deputy Chief Executive which has responsibility for co-ordinating the strategy for the Company's achievement of its responsibilities in this area.

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, (rather than absolute), assurance against material misstatement or loss.

The Board considers the management of risk and internal control to be fundamental to achievement of the Company's objectives and has formally established a policy, strategy and process for identification, evaluation and on-going review of the significant risks faced by the Company which accords with the Turnbull Guidance. During the year the Executive Directors have formally reviewed the key risks faced by the Company. The Directors keep

the effectiveness of the system of internal control under review and have done so throughout the year.

The risk management process is now well established and forms an integral part of the Network Rail planning and review activity. It incorporates the following:

- the identification of risks to the achievement of business objectives by all business units and major projects together with the likelihood/impact analysis and the development of mitigation actions to manage risks at the desired levels;
- the capture and recording of risks, risk scoring and action plans in a company wide risk management system;
- the regular reporting and review of business unit and major project risks to the Executive Directors at monthly business reviews; and
- the development of causal risk maps to provide an overview of strategic risk interaction across functions and to support regular review of the risk profile by the Audit Committee and the Board.

The Board, however, recognises that embedding risk management across the Company is an ongoing process and is committed to a programme of continual improvement which, during the last year, has included:

- the development of a Company Standard for risk management to provide for consistency of approach across business units;
- the introduction of a self certification process which requires function heads to confirm that the risk management processes are being complied with and that their risk data is accurate and complete; and
- peer leadership groups to review and challenge risk data and to increase awareness of best practice.

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

- regular structured reviews of all business units and major projects by the Executive Directors assessing progress against objectives with action being taken as required;
- a framework of delegated authority and accountability based on a templated organisation structure;

- Board approval of business strategies and objectives, together with plans, annual budgets and targets;
- the monthly reporting of financial results, safety and other operational key performance indicators;
- procedures for planning, approving and managing all investment expenditure including the use of the Guide to Railway Investment Projects (GRIP) specifying the requirement and timings for approvals sought by the Investment Panel and where above its delegated financial level, by the Executive Committee and the Board;
- centralised treasury operations operating within defined limits and overseen by the Treasury Committee;
- monthly accounting reviews to scrutinise financial data and increase confidence in the integrity of the accounts;
- continuous monitoring by the Legal Services function within the Company, of claims and litigation issues affecting the Company;
- governance of all business change initiatives through the Strategic Leadership Group; and
- commitment to continuous improvement in levels of competence via leadership, competency and training programmes.

The Company has an independent Internal Audit team that is affiliated to the Institute of Internal Auditors. Its primary role is to provide objective and independent assurance regarding the adequacy of the Company's internal control framework, compliance with policies, laws and regulations. Internal Audit is also responsible for reviewing the effective operation of the company wide risk management system as well as improving processes, providing advice and proliferating best practice.

The work of internal audit is focused on the areas of priority as identified by risk and materiality analysis and is in accordance with an annual audit plan which is approved by the Audit Committee. The Audit Committee receives regular reports on audit findings from the Head of Internal Audit, who has direct access to the Chairman of the Audit Committee. Recommendations to improve the internal control framework are reported to the Audit Committee through this process.

Internal Audit work closely with the External Auditors and other assurance providers to ensure co-ordination of audit plans and optimisation of audit resources. The Head of Internal Audit and the External Audit Partner meet on a regular basis.

The Company also has an established process by which staff may, in confidence, raise concerns about possible improprieties. Matters arising from the investigation of fraud are reported to the Audit Committee by the Head of Internal Audit.

During the course of its review of the system of internal control, the Board has not identified nor been advised of any failings or weaknesses which it has determined to be significant. Following the Cumbrian incident in February 2007, investigations have been instigated and are ongoing. Should any matters arise from these relating to relevant internal control issues these will be reviewed fully and appropriate action implemented.

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

Going concern

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

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements. The Directors are required to prepare financial statements for the Group in accordance with International Financial Reporting Standards (IFRSs) and have also elected to prepare financial statements for the Company in accordance with IFRS. Company law requires the Directors to prepare such financial statements in accordance with International Financial Reporting Standards, the Companies Act 1985 and Article 4 of the IAS Regulation.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all International Financial Reporting Standards. Directors are also required to:

- select applicable accounting policies and apply them properly;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- prepare the accounts on a going concern basis unless, having assessed the ability of the Company to continue as a going concern, management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and Group, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' Report and the Directors' Remuneration Report which comply with the requirements of the Companies Act 1985.

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

Independent auditors' report to the Members of Network Rail Infrastructure Limited

We have audited the Group and individual Company financial statements (the 'financial statements') of Network Rail Infrastructure Limited for the year ended 31 March 2007, which comprise the consolidated income statement, the consolidated and individual company statements of recognised income and expenses, the consolidated and individual company balance sheets, the consolidated and individual company cash flow statements and the related Notes 1 to 31. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the 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

The Directors' responsibilities for preparing the Annual Report, the Directors' remuneration report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted for use in the European Union are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

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 to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements. In addition, we report to you if, in our opinion, 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 other transactions is not disclosed.

The Directors have asked us to report to you if, in our opinion, the Company has not complied with any of the four Directors' remuneration disclosure requirements specified for our review as if the Listing Rules of the Financial Services Authority applied. These comprise the amount of each element in the remuneration package and information on share options, details of long term incentive schemes, and money purchase and defined benefit schemes. We give a statement, to the extent possible, of details of any non-compliance.

The Directors have asked us to review whether the corporate governance report on page 32 reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review as if the Listing Rules of the Financial Services Authority applied, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report including the unaudited part of the Directors' remuneration report and we consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

Basis of audit opinion

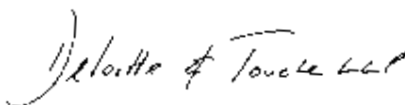
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' remuneration report to be 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 Group's and Company's circumstances, 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 to be 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 to be audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 March 2007 and of its profit for the year then ended;
- the individual company financial statements give a true and fair view, in accordance with IFRSs as adopted for use in the European Union as applied in accordance with the requirements of the Companies Act 1985, of the state of the individual company's affairs as at 31 March 2007;
- the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation; and
- the information given in the Directors' report is consistent with the financial statements.



Deloitte & Touche LLP

Chartered Accountants and Registered Auditors
London
24 May 2007

Income statement for the year ended 31 March 2007

	Notes	2007 Group £m	2006 Group £m
Revenue	3	5,795	3,837
Operating costs	5	(3,517)	(3,369)
Operating profit		2,278	468
Revaluation gains and profits on disposal of properties		102	78
Total profits from operations	6	2,380	546
Investment revenues	8	230	97
Finance costs	9	(1,132)	(875)
Profit/(loss) before tax		1,478	(232)
Tax	10	(443)	(21)
Profit/(loss) for the year attributable to equity shareholders		1,035	(253)

All amounts in the current and prior years relate to continuing operations.

Under section 230 of the Company's Act 1985 the group has elected to take the exemption with regard to disclosing the Company Income Statement. The Company's net profit for the year was £1,129m (2006: loss of £322m).

Statements of recognised income and expense for the year ended 31 March 2007

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Recognised income and expense in the year				
Gains on revaluation of the railway network	73	1,583	73	1,583
(Losses)/gains on cash flow hedges	(183)	1	33	(88)
Exchange differences on retranslation of foreign currency debt taken to hedging reserve	351	(178)	–	–
	168	(177)	33	(88)
Actuarial gains on defined benefit pension schemes	122	102	122	102
Tax on items taken directly to equity	(106)	(457)	(64)	(482)
Net income recognised directly in equity	257	1,051	164	1,115
Transfers				
Transferred to profit and loss on cash flow hedges	4	27	4	27
Tax on items transferred from equity	(1)	(8)	(1)	(8)
	3	19	3	19
Profit/(loss) for the year	1,035	(253)	1,129	(322)
Total recognised income and expense	1,295	817	1,296	812
Opening adjustments made on 1 April 2005 on transition to IAS 32 and IAS 39				
Opening value of derivatives on transition to IAS 32 and IAS 39	–	(100)	–	(100)
Opening exchange differences on translation of foreign currency debt on transition to IAS 32 and IAS 39	–	2	–	2
Deferred taxation on opening adjustments on transition to IAS 32 and IAS 39	–	34	–	34
	–	(64)	–	(64)
Total recognised income and expense for the year attributable to equity shareholders	1,295	753	1,296	748

Balance sheets at 31 March 2007

	Notes	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Assets					
Non-current assets					
Intangible assets	11	75	77	–	–
Property, plant and equipment – the railway network	12	28,304	25,991	28,304	25,991
Investment property	13	948	892	948	892
Investment in subsidiaries	14	–	–	49	49
Investments	15	–	161	–	–
Loan to immediate parent company		348	326	348	326
Derivative financial instruments	20	41	65	39	–
Finance lease receivables	17	16	19	16	19
Total financial assets		405	571	403	345
		29,732	27,531	29,704	27,277
Current assets					
Inventories	16	49	44	49	44
Finance lease receivables	17	3	3	3	3
Trade and other receivables	18	626	439	631	609
Derivative financial instruments	20	1	50	1	–
Cash and cash equivalents	18	193	31	13	31
		872	567	697	687
Total assets		30,604	28,098	30,401	27,964
Current liabilities					
Trade and other payables	23	(2,210)	(2,083)	(2,043)	(2,068)
Bank loans and overdrafts	19	(2,862)	(4,186)	(2,913)	(4,185)
Derivative financial instruments	20	(105)	(2)	(42)	(130)
Short-term provisions	24	(15)	(17)	(15)	(17)
		(5,192)	(6,288)	(5,013)	(6,400)
Net current liabilities		(4,320)	(5,721)	(4,316)	(5,713)
Non-current liabilities					
Bank loans	19	(15,715)	(14,197)	(15,902)	(14,009)
Derivative financial instruments	20	(199)	(45)	–	–
Other payables	23	(1,129)	(919)	(1,129)	(919)
Retirement benefit obligation	30	(248)	(359)	(248)	(359)
Deferred tax liabilities	21	(2,435)	(1,895)	(2,435)	(1,895)
Long-term provisions	24	(18)	(22)	(18)	(22)
Obligations under finance leases	22	(10)	(10)	(10)	(10)
		(19,754)	(17,447)	(19,742)	(17,214)
Total liabilities		(24,946)	(23,735)	(24,755)	(23,614)
Net assets		5,658	4,363	5,646	4,350
Equity					
Share capital	25	160	160	160	160
Share premium account	26	85	85	85	85
Revaluation reserve	26	4,247	4,337	4,247	4,337
Other reserve	26	1,451	1,451	1,451	1,451
Hedging reserve	26	(57)	(178)	(33)	(61)
Retained earnings	26	(228)	(1,492)	(264)	(1,622)
Total shareholders' funds and equity attributable to equity holders of the parent company		5,658	4,363	5,646	4,350

The financial statements were approved by the Board of Directors and authorised for issue on 24 May 2007.

They were signed on its behalf by:

John Armitt Director

Ron Henderson Director

Cash flow statements

for the year ended 31 March 2007

	Note	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Net cash generated from operating activities	27	2,428	655	2,460	662
Investing activities					
Interest received		71	35	47	35
Purchases of property, plant and equipment – the railway network		(3,256)	(3,088)	(3,256)	(3,088)
Proceeds on disposal of property, plant and equipment – the railway network		51	65	51	65
Capital grants received		169	95	169	95
Capital element of finance leases' receipts		3	6	3	6
Sale of available-for-sale investments		161	5	–	–
Net cash used in investing activities		(2,801)	(2,882)	(2,986)	(2,887)
Financing activities					
Repayments of borrowings		(9,900)	(6,852)	(9,927)	(6,852)
Repayments of obligations under finance leases		–	(8)	–	(8)
New loans raised		10,435	9,090	10,435	9,090
Net cash generated from financing activities		535	2,230	508	2,230
Net increase/(decrease) in cash and cash equivalents		162	3	(18)	5
Cash and cash equivalents at beginning of the year		31	28	31	26
Cash and cash equivalents at end of the year		193	31	13	31

Notes to the financial statements for the year ended 31 March 2007

1 General information

Network Rail Infrastructure Limited is a company incorporated in Great Britain and registered in England and Wales under the Companies Act 1985.

The Company registration number is: 2904587.

The Company's registered office is situated at 40 Melton Street, London NW1 2EE.

The Company's principal activities are detailed in the Directors' report on pages 14 to 19.

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

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

2 Significant accounting policies

Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted for use in the European Union and therefore comply with Article 4 of the EU IAS regulation.

The financial statements have been prepared on the historical cost basis, except for the revaluation of the railway network to the lower of its same state replacement cost and value in use, the revaluation of investment properties, investments and derivative financial instruments to fair value.

The principal accounting policies adopted by the directors are set out below.

Adoption of forthcoming standards

At the date of authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but have not yet come into effect:

IFRS 7 *Financial instruments: Disclosures*; and the related amendment to IAS 1 on capital disclosures

IFRS 8 *Operating Segments*

IFRIC 7 *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies*

IFRIC 8 *Scope of IFRS 2*

IFRIC 9 *Reassessment of Embedded Derivatives*

IFRIC 10 *Interim Financial Reporting and Impairment*

IFRIC 11 *IFRS 2 – Group and Treasury Share Transactions*

IFRIC 12 *Service Concession Arrangements*

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group except for additional disclosures on capital and financial instruments when the relevant standards come into effect for periods commencing on or after 1 January 2007. The additional disclosures under IFRS 7 include stating the carrying amount of financial assets and liabilities under each of the classifications in IAS 39 'Financial Instruments: Recognition and Measurement'; an analysis of the age for financial assets that are either past due or impaired; a reconciliation of changes in carrying amounts during a period where impairment is recorded through an allowance account as opposed to a direct reduction to the carrying amount of the financial asset; and additional requirements on providing sensitivity analysis on market risks and how changes in these risks would have impacted profit or loss and equity in the period.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Revenue recognition

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

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

Revenue from construction contracts is recognised in accordance with the Group's accounting policy on construction contracts on page 46.

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

2 Significant accounting policies continued

Grants

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

Construction contracts

Construction contracts are stated at cost plus estimated profits attributable to the stage of completion (where the outcome can be assessed with reasonable certainty), 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. Advance and progress payments are included under trade and other payables to the extent that they exceed the related cost. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Leasing

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

The Group as lessor

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

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

The Group as lessee

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

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

Foreign currencies

Monetary assets and liabilities expressed in foreign currencies are translated into sterling at rates of exchange prevailing at the balance sheet date. Individual transactions denominated in foreign currencies are translated into sterling at the exchange rates prevailing on the dates payment takes place. Gains and losses arising on retranslation are, with the exception of items that form part of a designated cash flow hedge relationship, included in the income statement for the period and are classified as either operating or financing depending on the nature of the monetary item giving rise to them.

Borrowing costs

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

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

Operating profit

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

Retirement benefit costs

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

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

The Group's share of the actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the income statement and presented in the statement of recognised income and expense (see Note 30).

Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight line basis over the average period until the benefits become vested.

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

2 Significant accounting policies continued

Tax

The tax expense represents the sum of the current tax payable and deferred tax. The Group's current tax liability is calculated using the tax rates that have been enacted or substantively enacted by the balance sheet date.

Current taxes are based on the taxable results of the Group and calculated in accordance with tax rules in the United Kingdom.

Deferred tax is the tax expected to be payable or recoverable on the temporary differences that arise when tax authorities recognise and measure assets and liabilities with rules that differ from those of the consolidated accounts. Deferred taxes are calculated under the balance sheet liability method at the rate of tax expected to prevail, subject to the rate being enacted or substantively enacted by that date, when the temporary differences reverse. Deferred tax is not discounted.

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

Deferred tax assets/liabilities are not recognised if the temporary differences arise from the initial recognition of goodwill, non deductible goodwill or from initial recognition (other than business combination) of other assets and liabilities in a transaction that affects neither the taxable profit or loss nor the accounting profit or loss.

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

Property, plant and equipment – the railway network

The railway network is valued at depreciated replacement cost. This is calculated at the lower of its same state replacement cost and its value in use. The value in use is based on a discounted future cash flow that assesses the value to the business of the net income stream of the railway network.

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. The remaining weighted average useful economic lives are estimated annually, with external verification of the valuation and asset lives carried out, where required, at least every five years.

Investment property

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

Research and development

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

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

Intangible fixed assets

An intangible asset is only recognised if it is probable that future economic benefits will flow to the Group and its costs can be measured reliably. Intangible fixed assets are measured initially at purchase cost and are amortised on a straight-line basis. Licenses are amortised over the length of their contractual agreement. Intangible fixed assets are tested for impairment at each balance sheet date by comparing their carrying value and the expected discounted cash flows expected to arise from them over their contractual agreements. If the carrying value exceeds the discounted cash flows expected to arise from the assets, the carrying value would be impaired accordingly.

Inventories

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

Financial instruments

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

Trade receivables

Trade receivables do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts, recognised in profit and loss.

2 Significant accounting policies continued

Investments

Investments are recognised and derecognised on a trade date where a purchase or sale of an investment is under contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at cost, including transaction costs.

Investments are classified as either held for trading or available-for-sale, and are measured at subsequent reporting dates at fair value. Where securities are held for trading purposes, gains and losses arising from changes in fair value are included in the income statement for the period. For available-for-sale investments, gains and losses from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the income statement for the period. Non-current asset instruments in subsidiaries are stated at cost less provision for impairment.

Financial liabilities and equity instruments

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities.

Debt

Debt instruments are recorded at the proceeds received, net of discount and direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs are accounted for on an accrual basis to the income statement using the effective interest rate method and are added to the carrying value of the debt instrument to the extent that they are not settled in the period in which they arise.

Trade payables

Trade payables are not interest bearing and are stated at cost.

Derivative financial instruments and hedge accounting

The Group's activities expose it primarily to the financial risks of changes in interest rates and foreign currency exchange rates. The Group uses interest rate swaps and foreign exchange forward contracts to hedge these exposures.

The use of financial derivatives is governed by the group's policies approved by the Treasury Committee of the Board, which provide written principles on the use of financial derivatives.

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity and the ineffective portion is recognised immediately in the income statement. If the cash flow hedge of a firm commitment or forecasted transaction results in the recognition of an asset or a liability, then, at the time the asset or liability is recognised, the associated gains or losses on the derivative that had been previously recognised in equity are included in the initial measurement of the asset or liability. For hedges that do not result in the recognition of an asset or a liability, amounts deferred in equity are recognised in the income statement in the same period in which the hedged items affect net profit and loss.

Changes in the fair value of derivative financial instruments that do not qualify for cash flow hedge accounting are recognised in the income statement as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement in the year.

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

Provisions

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

Key sources of estimation uncertainty

- (i) Property, plant and equipment – the railway network: the estimate of the value in use of the railway network is based on the Regulatory Asset Base, which is, in effect, a discounted future cash flow calculation adjusted for the net present value of any variances from the Office of Rail Regulation's determination included in the Group's Business Plan. Further details are set out in Note 12.
- (ii) Retirement benefit obligation: the Group recognises and discloses its retirement benefit obligation in accordance with the measurement and presentational requirement of IAS 19 'Employee Benefits'. The calculations include a number of judgements and estimations in respect of the expected rate of return on assets, the discount rate, inflation assumptions, the rate of increase in salaries and life expectancy amongst others. Changes in these assumptions can have a significant effect on the value of the retirement benefit obligation. The key assumptions made are set out in Note 30.

3 Revenue

	2007 Group £m	2006 Group £m
Passenger franchise revenue	2,206	1,515
Revenue grants	3,227	1,983
Freight revenue	95	97
Property rental income	206	183
Other income	61	59
	5,795	3,837

The net effect of the performance regimes on the results of the Group and Company was net income of £89m (year to 31 March 2006: net income of £110m).

4 Segmental analysis

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

5 Operating costs

	2007 Group £m	2006 Group £m
Employee costs (see Note 7)	1,401	1,292
Own costs capitalised	(482)	(409)
Other external charges (including infrastructure maintenance costs)	1,691	1,674
Other operating income	(148)	(126)
Operating costs before depreciation	2,462	2,431
Depreciation and other amounts written off non-current assets	1,086	964
Capital grants amortised	(31)	(26)
Operating costs	3,517	3,369

6 Profit from operations

Profit from operations is stated after charging/(crediting):

	2007 Group £m	2006 Group £m
Research and development costs	1	2
Depreciation and other amounts written off property, plant & equipment	1,086	964
Amortisation of intangible fixed assets	2	2
Profit on sale of properties	(47)	(61)
Increase in the fair value of investment properties	(55)	(17)
Cost of inventories recognised as an expense	187	166
Employee costs (see Note 7)	1,401	1,292
Amounts payable to auditors		
Fees payable to the Company's auditors for the audit of the Company's annual accounts	0.35	0.34
Fees payable to the Company's auditors for other services to the Group		
– The audit of the Company's subsidiaries pursuant to legislation	0.03	0.03
Total audit fees	0.38	0.37
Other services pursuant to legislation		
– Regulatory accounts audit and interim review	0.12	0.12
– Other	0.01	0.01
Total non-audit fees	0.13	0.13

7 Employee costs

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

	2007 Group Number	2006 Group Number
Management and operation of the railway	33,446	31,584

	2007 Group £m	2006 Group £m
Their aggregate remuneration comprised:		
Wages and salaries	1,178	1,084
Social security costs	102	93
Defined contribution pension costs (see Note 30)	11	3
Defined benefit pension costs – current service costs (see Note 30)	110	112
	1,401	1,292

8 Investment revenue

Investment revenue and foreign exchange gains are presented net of effective cash flow hedges for respective interest bearing and foreign currency borrowings. Fair value gains on derivatives, presented below, include the mark-to-market change of interest rate and currency derivatives designated as fair value hedges.

	2007 Group £m	2006 Group £m
Interest receivable from immediate parent company	21	19
Interest receivable on investments and deposits	27	13
Interest receivable on finance leases	2	2
Increase in fair value of fair value hedged debt	85	7
Ineffective portion of cash flow hedges	35	22
Increase in fair value of non hedge accounted debt	20	–
Increase in fair value of derivatives not hedge accounted	2	34
Exchange differences on retranslation of foreign currency debt taken directly to income statement	21	–
Expected return on assets less interest on liabilities in respect of defined benefit pension scheme	17	–
	230	97

9 Finance costs

Finance costs and foreign exchange losses are presented net of effective cash flow hedges for respective interest bearing and foreign currency borrowings. Fair value losses on derivatives, presented below, include the mark-to-market change of interest rate and currency derivatives designated as fair value hedges.

	2007 Group £m	2006 Group £m
Interest on bank loans and overdrafts	65	18
Interest on bonds issued under the Debt Issuance Programme	475	356
Interest on debt issued under Medium Term Note Programme	296	353
Interest on commercial paper	78	103
Interest on obligations under finance leases	12	16
Expected return on assets less interest on liabilities in respect of defined benefit pension scheme	–	21
Other interest	93	5
Total borrowing costs	1,019	872
Less: amounts included in the cost of qualifying assets	(75)	(70)
Total finance costs before remeasurements	944	802
Decrease in fair value of fair value hedges	85	7
Ineffective portion of cash flow hedges	49	–
Decrease in fair value of derivatives not hedge accounted	50	–
Fair value losses on interest rate swaps transferred from equity	4	27
Exchange differences on retranslation of foreign currency debt taken directly to income statement	–	39
Total finance costs	1,132	875

Borrowing costs are included in the costs of qualifying assets to the extent that the asset is financed by the Company. The average rate used during the year was 5.0% (2006: 5.01%).

10 Tax

	2007 Group £m	2006 Group £m
Current tax:		
UK Corporation tax at 30%:		
Corporation tax charge	(11)	–
Less Advance Corporation Tax set off	7	–
Corporation tax liability	(4)	–
Group relief payable	(6)	–
Total current tax	(10)	–
Deferred tax:		
Deferred tax at 30%:		
Current year (charge)/credit	(424)	34
Prior year charge	(9)	(55)
Total deferred tax	(433)	(21)
Total tax	(443)	(21)

The tax charge for the year can be reconciled to the profit/(loss) per the income statement as follows:

	2007 Group £m	2006 Group £m
Profit/(loss) before tax	1,478	(232)
Tax at the UK corporation tax rate of 30%	443	(70)
Adjustments in respect of prior years	9	55
Permanent differences	(2)	36
Advance Corporation Tax previously written off	(7)	–
Tax charge for the year	443	21

In addition to the amounts charged to the income statement, deferred tax relating to the revaluation of the railway network amounting to £19m (2006: £476m), movements on the hedging reserve amounting to £51m (2006: £76m credit) and relating to retirement benefit obligations amounting to £37m (2006: £31m charge) have been charged directly to equity.

UK corporation tax and deferred tax is calculated at a rate of 30% (2006: 30%).

The Company and the Group have £39m (2006: £46m) of surplus Advance Corporation Tax carried forward. No deferred tax asset has been provided in respect of this amount as it is uncertain that it can be utilised against tax liabilities in the foreseeable future.

The Budget in March 2007 proposed certain changes in relation to future corporation tax rates and future capital allowances. As these changes were not substantively enacted at the balance sheet date their impact has not been recognised in these accounts. An estimate of the financial effect of these changes cannot currently be made.

11 Intangible assets

Group	Concessions £m
Cost	
At 1 April 2005, 1 April 2006 and 31 March 2007	83
Amortisation	
At 1 April 2005	(4)
Charge for the year	(2)
At 1 April 2006	(6)
Charge for the year	(2)
At 31 March 2007	(8)
Carrying amount	
At 31 March 2007	75
At 31 March 2006	77

The intangible assets above are held by the Company's wholly owned subsidiary Network Rail (CTRL) Limited.

The concession to run the operations, maintenance and renewal business of the Channel Tunnel Rail Link is being amortised over 84 years, to 2086.

12 Property, plant and equipment – the railway network

Group and Company £m	
Valuation	
At 1 April 2005	22,221
Additions	3,151
Depreciation charge for the year	(964)
Revaluation in the year	1,583
At 1 April 2006	25,991
Additions	3,326
Depreciation charge for the year	(1,086)
Revaluation in the year	73
At 31 March 2007	28,304

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

Ove Arup and Partners carried out an interim review in the year ended 31 March 2005 of the Company's engineering assessment of the replacement cost, depreciated replacement cost and useful economic lives of the railway network assets. This interim review updated the full review carried out in the year ended 31 March 2003. Ove Arup and Partners confirmed in writing that the basis upon which the assessment was prepared continued to be appropriate and that there had been no material changes to the valuations and estimates derived in the year ended 31 March 2003.

The Directors have reviewed the assessments in the current year and are satisfied that they remain valid and appropriate at 31 March 2007. A full review of the valuation and asset lives is prepared and externally verified at least every five years.

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

As the depreciated replacement cost of the railway network significantly exceeds its value in use, it is impaired down to its value in use at each reporting date. Given the interdependency of the assets comprising the railway network, the Group has concluded that the railway network is a single cash generating unit and that its value in use is the estimated future cash flows that will be generated in perpetuity, discounted at the Group's pre-tax cost of capital, as set by the Office of Rail Regulation (ORR) in its Access Charges Review. The estimate of the value in use is based on the Regulatory Asset Base (RAB) which is, in effect, a discounted future cash flow calculation adjusted for the net present value of any variances from the ORR's Determination included in the Group's Business Plans.

12 Property, plant and equipment – the railway network continued

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

As at 31 March 2007 the comparable valuation of the railway network according to the historic cost convention is £21,927m.

As at 31 March 2007 and 31 March 2006 it is not possible to identify the undepreciated capitalised interest or the undepreciated finance leases, within the net book value of fixed assets. The undepreciated interest capitalised since the date of adoption of the network value as deemed cost on 1 April 2002 was £195m (2006: £116m). No finance leased assets have been acquired since 1 April 2002.

At 31 March 2007, the Group had entered into contractual commitments in respect of capital expenditure amounting to £1,077m (2006: £1,091m).

13 Investment property

	Group and Company £m
Fair value	
At 1 April 2005	872
Additions	7
Disposals	(4)
Increase in fair value in the year	17
At 1 April 2006	892
Additions	5
Disposals	(4)
Increase in fair value in the year	55
At 31 March 2007	948

The fair value of the Group's investment properties at 31 March 2007 has been arrived at on the basis of a valuation carried out at that date by Jones Lang LaSalle, external valuers not connected with the Group, and by the Head of Corporate Real Estate, Network Rail.

The valuation which conforms to International Valuation Standards, was arrived at by, firstly, the external valuation of the 17 largest properties amounting to 13% of the total valuation. Secondly, the balance of the estate, amounting to 6,773 properties, was valued using the Beacon method. The portfolio was analysed into 12 homogenous classes of property and areas. Jones Lang LaSalle independently assessed the appropriate yield to be adopted within each of the portfolio classes/areas in order to enable the directors to estimate market values by applying the adopted yields to the net rental income in accordance with a traditional UK investment property valuation.

The property rental income earned by the Group from its investment property, all of which is leased out under operating leases, amounted to £72m (2006: £72m). Direct operating expenses arising on the investment properties in the year amounted to £4m (2006: £4m).

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

14 Investment in subsidiaries: CompanyAt cost
£m**Investment in subsidiaries at 1 April 2005, 1 April 2006 and 31 March 2007****49**

The Company's subsidiaries are set out below:

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

The shares in Network Rail MTN Finance PLC and Network Rail Infrastructure Finance PLC are held by HSBC Trustee (C.I.) Limited for charitable purposes. The sole activity of these companies is to act as a special purpose funding vehicle, including issuing debt under the Medium Term Note programme and Debt Issuance Programme respectively. The companies are treated as subsidiaries for accounting purposes as proceeds from the Medium Term Note programme and Debt Issuance Programme are on-lent to Network Rail Infrastructure Limited and are used to finance the activities of the Company and to refinance the existing debt of the Group.

15 Investments

	Group £m	Company £m
At 1 April 2005	166	–
Disposals	(5)	–
At 1 April 2006	161	–
Disposals	(161)	–
At 31 March 2007	–	–

The investments included above represent amounts held by the Group's captive insurance company, Network Rail Insurance Limited.

16 Inventories

	2007 Group and Company £m	2006 Group and Company £m
Raw materials and consumables	49	44

17 Finance lease receivables

	Minimum lease payments		Present value of minimum lease payments	
	2007 Group and Company £m	2006 Group and Company £m	2007 Group and Company £m	2006 Group and Company £m
Amounts receivable under finance leases:				
Within one year	5	5	3	3
In the second to fifth years inclusive	13	16	10	12
After five years	7	9	6	7
	25	30	19	22
Less: unearned finance income	(6)	(8)	n/a	n/a
Present value of minimum lease payments receivable	19	22	19	22
Analysed as:				
Current finance lease receivables (recoverable within one year)			3	3
Non-current finance lease receivables (recoverable after one year)			16	19
			19	22

The Group has entered into finance lease arrangements with third parties for various types of telecommunications equipment. Leases are due to expire in 2017/18.

The interest rate inherent in the leases is fixed at the contract date for all of the lease term. The average effective interest rate contracted is approximately 8.4% (2006: 8.6%) per annum.

The fair value of the Group's finance lease receivables at 31 March 2007 is estimated at £16m (2006: £18m).

18 Other financial assets**Trade and other receivables**

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Trade receivables	319	122	307	113
Amounts due from construction contract customers	1	1	1	1
Amounts owed from other group companies	–	–	83	76
Capital grants receivable	43	33	43	33
Other receivables	158	82	92	185
Prepayments and accrued income	105	201	105	201
	626	439	631	609

Average debtor days were 37 days (2006: 27 days). An allowance has been made for estimated irrecoverable amounts from the supply of services of £4m (2006: £9m). This allowance has been made by reference to past default experience.

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

The Group's credit risk is primarily attributable to its trade receivables. The Group has no significant concentration of credit risk, with exposure spread over a large number of counterparties and customers.

Cash and cash equivalents

Cash and cash equivalents comprise bank balances held by the group and money market deposit investments. The carrying amount of these assets approximates to their fair value. The credit risk on liquid funds is limited because the counterparties are banks with high credit ratings assigned by international credit rating agencies.

19 Bank overdrafts and loans

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Bank loans and overdrafts	1,482	1,139	329	339
Bonds issued under the Debt Issuance Programme (less unamortised discount and fees)	10,794	8,081	–	–
Debt issued under Medium Term Note programme (less unamortised discount and fees)	4,826	5,857	–	–
Commercial paper	1,260	3,078	–	–
Kreditanstalt für Wiederaufbau working capital facility	215	228	–	–
Loans from subsidiaries	–	–	18,486	17,855
	18,577	18,383	18,815	18,194
The borrowings are repayable as follows:				
On demand or due within one year	2,862	4,186	2,913	4,186
Due within one to two years	4,722	1,502	4,761	1,502
Due within two to five years	3,051	6,122	3,140	6,122
Due in more than five years	7,942	6,573	8,001	6,384
	18,577	18,383	18,815	18,194
Less: amounts repayable within one year (shown under current liabilities):				
Bank loans and overdrafts	(100)	(7)	–	(7)
Bonds issued under the Debt Issuance Programme (less unamortised discount and fees)	(399)	–	–	–
Debt issued under Medium Term Note programme (less unamortised discount and fees)	(888)	(873)	–	–
Commercial paper	(1,260)	(3,078)	–	–
Kreditanstalt für Wiederaufbau working capital facility	(215)	(228)	–	–
Loans from subsidiary	–	–	(2,913)	(4,178)
Amounts repayable within one year	(2,862)	(4,186)	(2,913)	(4,185)
Amounts repayable after more than one year	15,715	14,197	15,902	14,009

All borrowings are denominated in or swapped into sterling.

19 Bank overdrafts and loans continued

Bonds issued under the Debt Issuance Programme are analysed as follows*:

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
1.5646% Sterling index linked bond due 2044	207	201	—	—
1.2219% Sterling index linked bond due 2040	207	201	—	—
7.05% US Dollar bond due 2036	13	—	—	—
6.91% US Dollar bond due 2036	13	—	—	—
4.75% Sterling bond due 2035	1,220	1,219	—	—
1.6492% Sterling index linked bond due 2035	315	305	—	—
4.375% Sterling bond due 2030	868	868	—	—
4.57% Norwegian Krone bond due 2026	11	—	—	—
4.615% Norwegian Krone bond due 2026	40	—	—	—
1.9618% Sterling index linked bond due 2025	264	256	—	—
4.75% Sterling bond due 2024	720	719	—	—
4.3775% Sterling bond due 2023	200	—	—	—
2.28% Japanese Yen bond due 2021	43	—	—	—
2.315% Japanese Yen bond due 2021	45	—	—	—
2.15% Japanese Yen bond due 2021	43	—	—	—
2.76% Swiss Franc bond due 2021	123	—	—	—
4.625% Sterling bond due 2020	995	995	—	—
5.0575% US Dollar bond due 2017	24	—	—	—
4.40% Canadian Dollar bond due 2016	219	245	—	—
6% Australian Dollar bond due 2016	202	—	—	—
4.875% Sterling bond due 2015	988	740	—	—
4.375% Sterling bond due 2011	446	249	—	—
5.25% US Dollar bond due 2011	515	—	—	—
5.50% Australian Dollar bond due 2010	349	351	—	—
5.125% Sterling bond due 2010	498	—	—	—
3.875% US Dollar bond due 2009	507	574	—	—
4.875% US Dollar bond due 2009	636	—	—	—
4.46% Sterling bond due 2008	50	50	—	—
4.125% US Dollar bond due 2008	634	718	—	—
4.50% Sterling bond due 2008	399	398	—	—
Fair value of debt fair value hedges	—	(8)	—	—
	10,794	8,081	—	—

* Amounts are shown net of unamortised discount and fees.

19 Bank overdrafts and loans continued

Debt issued under the Medium Term Note programme is analysed as follows*:

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
4 7/8% sterling Medium Term Note due 2009	2,244	2,241	—	—
3 1/8% Euro Medium Term Note due 2009	1,694	1,739	—	—
2 5/8% US dollar Medium Term Note due 2008	634	717	—	—
2 5/8% US dollar Medium Term Note due 2008	254	287	—	—
Floating rate Euro Medium Term Note due 2007	—	873	—	—
	4,826	5,857	—	—

Bank loans repayable are analysed as follows:

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Index-linked European Investment Bank due 2037	353	—	—	—
HSBC Bank due 2019 repayable by instalments	206	206	206	206
Barclays Bank due 2017 repayable by instalments	55	58	55	58
Royal Bank of Scotland due 2017 repayable by instalments	68	68	68	68
5.57% European Investment Bank due 2013	200	200	—	—
5.77% European Investment Bank due 2012	300	300	—	—
6.42% European Investment Bank due 2011	100	100	—	—
6.42% European Investment Bank due 2009	100	100	—	—
European Investment Bank due 2007	100	100	—	—
	1,482	1,132	329	332

The weighted average interest rates on borrowings at 31 March 2006 and 2007 were as follows:

	2007 Group %	2006 Group %	2007 Company %	2006 Company %
Bank loans and overdrafts	5.45	5.31	5.45	5.31
Debt issued under the Debt Issuance Programme	4.85	4.82	—	—
Debt issued under the Medium Term Note programme	5.25	5.26	—	—
Debt issued under the Commercial Paper programme	5.25	4.79	—	4.79

Debt of £16,770m (2006: £16,116m) is arranged at fixed interest rates and exposes the Group to fair value interest rate risk. Other borrowings were arranged at floating rates, thus exposing the Group to cash flow interest rate risk.

The Directors estimate the fair value of the Group's borrowings as follows:

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Bank loans and overdrafts	(1,459)	(1,422)	(329)	(332)
Debt issued under the Debt Issuance Programme	(12,304)	(11,365)	—	—
Debt issued under Medium Term Note programme	(4,758)	(5,547)	—	—
Loan from subsidiaries	—	—	(17,861)	(17,712)
	(18,521)	(18,334)	(18,190)	(18,044)

At 31 March 2006 and 2007 the Group had the following undrawn committed borrowing facilities.

	2007 Drawn £m	2007 Undrawn £m	2007 Total £m	2006 Drawn £m	2006 Undrawn £m	2006 Total £m
Working capital facility	—	1,000	1,000	—	2,750	2,750
Standby facility A	—	4,000	4,000	—	4,000	4,000
	—	5,000	5,000	—	6,750	6,750

* Amounts are shown net of unamortised discount and fees.

19 Bank overdrafts and loans continued

Undrawn committed facilities expire as follows:

	2007 £m	2006 £m
Within one year	1,000	2,750
Within one to two years	—	—
Within two to five years	4,000	4,000
	5,000	6,750

Not included in the above analysis are the £1,150m European Investment Bank and £215m Kreditanstalt für Wiederaufbau facilities as these were fully drawn as at 31 March 2007.

In addition the Secretary of State for Transport has provided support facilities in respect of the facilities listed below:

- Unlimited financial indemnity in respect of borrowings under the Debt Issuance Programme
- Medium Term Note programme
- £1,150m European Investment Bank
- £215m Kreditanstalt für Wiederaufbau

The support facilities provided by the Secretary of State for Transport cover amounts payable under the relevant facilities.

An integral part of the Railways Act 2005 (which received Royal Assent on 7 April 2005) was the intention to create a Transfer Scheme which enabled the transfer to the Secretary of State for Transport (SoS) of the property, rights and liabilities of the Strategic Rail Authority (SRA) relating to the indebtedness of Network Rail. This Transfer Scheme took effect on Sunday 26 June 2005 and with effect from this date, the SoS was treated as the same person in law as the SRA. The debt support obligations which were transferred from the SRA to the SoS include those under the Debt Issuance Programme, (being the Financial Indemnity). As a result of the Transfer Scheme, the debt support obligations for Network Rail's debt became direct sovereign obligations of the Crown.

20 Derivative financial instruments

The Group and Company uses derivative financial instruments to reduce exposure to foreign exchange risk and interest rate movements.

The Group and Company does not use derivative financial instruments for speculative purposes, however it may wish to designate certain derivatives as hedges. Such derivatives that are not hedge accounted are fair valued immediately through the income statement. The Group and Company has a comprehensive risk management process. The Board have approved and monitor the risk management processes, including documented treasury policies, counterparty limits, controlling and reporting structures.

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

The credit risk with regard to derivative financial instruments and other funds is limited because the counterparties are banks with high credit ratings assigned by international credit rating agencies. The Group and Company spreads its exposure over a number of counterparties.

Foreign exchange risk is managed by the use of forward exchange contracts, and currency swaps to limit the effects of movements in exchange rates on foreign currency denominated liabilities.

Interest rate risk is managed by the use of interest rate swaps to manage exposure to interest rate movements on a portion of existing debt.

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

20 Derivative financial instruments continued

	2007 Group		2007 Company	
	Fair value £m	Notional amounts £m	Fair value £m	Notional amounts £m
Cash flow hedges				
Cross-currency swaps to hedge debt issued under Debt Issuance Programme	27	1,790	27	1,790
Cross-currency swaps to hedge debt issued under Medium Term Note programme	1	1,074	–	–
Forward starting interest rate swaps	5	1,237	5	1,237
Forward starting cross-currency swaps	1	547	–	–
Interest rate swaps	8	400	8	400
Non-hedge accounted derivatives				
Cross-currency swaps to hedge debt issued under Debt Issuance Programme	–	27	–	–
	42	5,075	40	3,427
Included in non current assets	41	–	39	–
Included in current assets	1	–	1	–
Derivative Financial Instrument Assets	42	–	40	–
Cash flow hedges				
Cross-currency swaps to hedge debt issued under Debt Issuance Programme	(90)	1,586	–	–
Cross-currency swaps to hedge debt issued under Medium Term Note programme	(94)	1,568	–	–
Forward starting interest rate swaps	–	250	–	–
Fair Value Hedges				
Cross-currency swaps to hedge debt issued under Debt Issuance Programme	(92)	1,786	–	–
Embedded derivatives in the inter-company borrowings	–	–	(42)	8,350
Non-hedge accounted derivatives				
Cross-currency swaps to hedge debt issued under Debt Issuance Programme	(28)	1,512	–	–
	(304)	6,702	(42)	8,350
Included in current liabilities	(105)	–	(42)	–
Included in non current liabilities	(199)	–	–	–
Derivative Financial Instrument Liabilities	(304)	–	(42)	–
2006 Group				
	2007 Group		2006 Group	
	Fair value £m	Notional amounts £m	Fair value £m	Notional amounts £m
Cash flow hedges				
Cross-currency swaps to hedge debt issued under Debt Issuance Programme	(63)	3,376	22	1,586
Cross-currency swaps to hedge debt issued under Medium Term Note programme	(93)	2,642	33	3,482
Forward starting interest rate swaps	5	1,487	1	1,590
Forward starting cross-currency swaps	1	547	–	–
Interest rate swaps	8	400	(1)	328
Fair Value Hedges				
Cross-currency swaps to hedge debt issued under Debt Issuance Programme	(92)	1,786	(7)	250
Non-hedge accounted derivatives				
Cross-currency swaps to hedge debt issued under Debt Issuance Programme	(28)	1,539	–	–
Currency derivatives	–	–	20	2,590
	(262)	11,777	68	9,826
2006 Company				
	2007 Company		2006 Company	
	Fair value £m	Notional amounts £m	Fair value £m	Notional amounts £m
Cross-currency swaps to hedge debt issued under Debt Issuance Programme	27	1,790	–	–
Forward starting interest rate swaps	5	1,237	–	–
Interest rate swaps	8	400	–	–
Embedded derivatives in the inter-company borrowings	(42)	8,350	(130)	9,826
	(2)	11,777	(130)	9,826

Some derivatives, while complying with the Group's financial risk management policies, do not qualify for hedge accounting and are therefore classified as held for trading.

21 Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and Company and movement thereon during the current and prior years.

Group	Accelerated tax depreciation £m	Revaluation of railway network £m	Retirement benefit obligations £m	Derivatives £m	Tax losses £m	Total £m
At 1 April 2005	1,865	1,439	(133)	(34)	(1,727)	1,410
Charge/(credit) to income	345	–	(14)	7	(317)	21
Charge/(credit) to equity	54	422	31	(43)	–	464
At 1 April 2006	2,264	1,861	(116)	(70)	(2,044)	1,895
Charge/(credit) to income	276	–	(4)	(10)	171	433
Charge/(credit) to equity	61	(42)	37	51	–	107
At 31 March 2007	2,601	1,819	(83)	(29)	(1,873)	2,435

Company	Accelerated tax depreciation £m	Revaluation of railway network £m	Retirement benefit obligations £m	Derivatives £m	Tax losses £m	Total £m
At 1 April 2005	1,865	1,439	(133)	(34)	(1,727)	1,410
Charge/(credit) to income	345	–	(14)	7	(317)	21
Charge/(credit) to equity	54	422	31	(43)	–	464
At 1 April 2006	2,264	1,861	(116)	(70)	(2,044)	1,895
Charge/(credit) to income	276	–	(4)	29	174	475
Charge/(credit) to equity	61	(42)	37	9	–	65
At 31 March 2007	2,601	1,819	(83)	(32)	(1,870)	2,435

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

	2007 £m	2006 £m
Deferred tax liabilities	4,420	4,124
Deferred tax assets	(1,985)	(2,229)
	2,435	1,895

Network Rail Infrastructure Limited has a potential deferred tax asset relating to the disposal of the track bed which is carried at zero in the accounts. It is not possible to determine reliably the tax base of the asset which would be determined by negotiation with the Inland Revenue and therefore it has not been possible to reliably quantify the potential deferred tax asset. Had it been possible to do so, the potential deferred tax asset would not have been recognised in these accounts as it is not considered probable that suitable taxable profits will be available against which the deferred tax asset can be utilised.

22 Obligations under finance leases

	Minimum lease payments		Present value of minimum lease payments	
	2007 Group and Company £m	2006 Group and Company £m	2007 Group and Company £m	2006 Group and Company £m
Amounts payable under finance leases:				
Within one year	1	1	–	–
In the second to fifth years inclusive	4	4	2	2
After five years	10	11	8	8
	15	16	10	10
Less: future finance charges	(5)	(6)	n/a	n/a
Present value of lease obligations	10	10	10	10
Less: amounts repayable within one year (shown under current liabilities)			–	–
Amounts repayable after more than one year			10	10

The Group leases certain fixtures and fittings under finance leases from third parties. All lease obligations are denominated in sterling. The fair value of the Group's lease obligations approximates their carrying amount. The Group's obligations under finance leases are secured by the lessors' charges over the leased assets. For the year ended 31 March 2007, the effective borrowing rate was 5.1% (2006: 5.1%). Interest rates are fixed at contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rent payments.

23 Trade and other payables**Current liabilities: Trade and other payables**

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Trade creditors	620	589	607	574
Amounts due to construction contract customers	1	–	1	–
Payments received on account	12	11	12	11
Taxation and social security	38	–	38	–
Other creditors	325	357	294	357
Other interest accruals	227	153	221	153
Other accruals and deferred income	987	973	870	973
	2,210	2,083	2,043	2,068

The average credit period taken for trade purchases is 51 days (2006: 49 days).

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

Non-current liabilities: Other payables

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Deferred development income	87	117	87	117
Capital grants deferred income	951	802	951	802
Other payables	91	–	91	–
	1,129	919	1,129	919

24 Provisions: Group and Company

	Environmental provision £m	Other provisions £m	Total £m
At 1 April 2005			
Additional provision in the year	22	39	61
Utilisation of provision	–	–	–
	(5)	(17)	(22)
At 1 April 2006	17	22	39
Additional provision in the year	–	13	13
Utilisation of provision	(17)	(2)	(19)
At 31 March 2007	–	33	33
Included in current liabilities	–	15	15
Included in non-current liabilities	–	18	18
	–	33	33

The Group had previously 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 all costs have been incurred and so no further provision is required.

In addition, the Group 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.

25 Share capital

	2007 Group and Company £m	2006 Group and Company £m
Authorised:		
50,200,000 ordinary shares of 0.1p each	–	–
500,000,000 redeemable shares of £1 each	500	500
	500	500
Issued and fully paid:		
50,084,937 ordinary shares of 0.1p each	–	–
160,000,000 redeemable shares of £1 each	160	160
	160	160

The Company has the option to repurchase any or all of the redeemable shares at any date after 31 March 2003. No premium is repayable on such redemption and the option to repurchase has no expiry date. The redeemable shareholders have no right to redemption at their instigation. Redeemable shares do not carry voting rights, or rank for dividend, but may do so if the Company passes a resolution to that effect.

26 Reconciliation of changes in equity

Group	Share capital £m	Share Premium £m	Revaluation Reserve £m	Other Reserve* £m	Hedging Reserve £m	Retained Earnings £m	Total £m
At 1 April 2005	160	85	3,357	1,451	–	(1,443)	3,610
Opening adjustments made on 1 April 2005 on transition to IAS 32 and IAS 39							
Opening value of derivatives on transition to IAS 32 and IAS 39	–	–	–	–	(85)	(15)	(100)
Opening exchange differences on retranslation of foreign currency debt on transition to IAS 32 and IAS 39	–	–	–	–	(19)	21	2
Opening deferred taxation on transition to IAS 32 and IAS 39	–	–	–	–	34	–	34
							(64)
Revaluation of the railway network	–	–	1,583	–	–	–	1,583
Transfer of deemed cost depreciation from revaluation reserve	–	–	(181)	–	–	181	–
Increase in deferred tax liability on the railway network	–	–	(422)	–	–	(54)	(476)
Actuarial gains on defined benefit pension schemes	–	–	–	–	–	102	102
Deferred tax on actuarial gains	–	–	–	–	–	(31)	(31)
Deferred taxation on all hedging reserve movements/retained earnings	–	–	–	–	50	–	50
Increase in fair value of hedging derivatives	–	–	–	–	1	–	1
Exchange differences on retranslation of foreign currency debt	–	–	–	–	(178)	–	(178)
Transfers							
Transferred to income statement on disposal of cash flow hedges	–	–	–	–	25	–	25
Recycling of balances in hedging reserve to the income statement	–	–	–	–	2	–	2
Deferred tax on transfers	–	–	–	–	(8)	–	(8)
Net loss for the year	–	–	–	–	–	(253)	(253)
At 31 March 2006	160	85	4,337	1,451	(178)	(1,492)	4,363
Revaluation of the railway network	–	–	73	–	–	–	73
Transfer of deemed cost depreciation from revaluation reserve	–	–	(205)	–	–	205	–
Increase in deferred tax liability on the railway network	–	–	42	–	–	(61)	(19)
Actuarial gains on defined benefit pension schemes	–	–	–	–	–	122	122
Deferred tax on actuarial gains	–	–	–	–	–	(37)	(37)
Deferred taxation on all hedging reserve movements/retained earnings	–	–	–	–	(50)	–	(50)
Decrease in fair value of hedging derivatives	–	–	–	–	(183)	–	(183)
Exchange differences on retranslation of foreign currency debt	–	–	–	–	351	–	351
Transfers							
Recycling of balances in hedging reserve to the income statement	–	–	–	–	4	–	4
Deferred tax on transfers	–	–	–	–	(1)	–	(1)
Net profit for the year	–	–	–	–	–	1,035	1,035
At 31 March 2007	160	85	4,247	1,451	(57)	(228)	5,658

* Other reserves of £1,451m comprise the vesting reserve (2006: £1,451m) on privatisation.

26 Reconciliation of changes in equity continued

Company	Share capital £m	Share Premium £m	Revaluation Reserve £m	Other Reserve* £m	Hedging Reserve £m	Retained Earnings £m	Total £m
At 1 April 2005	160	85	3,357	1,451	–	(1,451)	3,602
Opening adjustments made on 1 April 2005 on transition to IAS 32 and IAS 39							
Opening value of derivatives on transition to IAS 32 and IAS 39	–	–	–	–	(28)	(72)	(100)
Opening exchange differences on retranslation of foreign currency debt on transition to IAS 32 and IAS 39	–	–	–	–	–	2	2
Opening deferred taxation on transition to IAS 32 and IAS 39	–	–	–	–	11	23	34
							(64)
Revaluation of the railway network	–	–	1,583	–	–	–	1,583
Transfer of deemed cost depreciation from revaluation reserve	–	–	(181)	–	–	181	–
Increase in deferred tax liability on the railway network	–	–	(422)	–	–	(54)	(476)
Actuarial gains on defined benefit pension schemes	–	–	–	–	–	102	102
Deferred tax on actuarial gains	–	–	–	–	–	(31)	(31)
Deferred taxation on all hedging reserve movements/retained earnings	–	–	–	–	17	–	17
Decrease in fair value of hedging derivatives	–	–	–	–	(88)	–	(88)
Transfers							
Transferred to income statement on disposal of cash flow hedges	–	–	–	–	25	–	25
Recycling of balances in hedging reserve to the income statement	–	–	–	–	2	–	2
Net loss for the year	–	–	–	–	–	(322)	(322)
At 31 March 2006	160	85	4,337	1,451	(61)	(1,622)	4,350
Revaluation of the railway network	–	–	73	–	–	–	73
Transfer of deemed cost depreciation from revaluation reserve	–	–	(205)	–	–	205	–
Increase in deferred tax liability on the railway network	–	–	42	–	–	(61)	(19)
Actuarial gains on defined benefit pension schemes	–	–	–	–	–	122	122
Deferred tax on actuarial gains	–	–	–	–	–	(37)	(37)
Deferred taxation on all hedging reserve movements/retained earnings	–	–	–	–	(8)	–	(8)
Increase in fair value of hedging derivatives	–	–	–	–	33	–	33
Transfers							
Recycling of balances in hedging reserve to the income statement	–	–	–	–	4	–	4
Deferred tax on transfers	–	–	–	–	(1)	–	(1)
Net profit for the year	–	–	–	–	–	1,129	1,129
At 31 March 2007	160	85	4,247	1,451	(33)	(264)	5,646

* Other reserves of £1,451m comprise the vesting reserve (2006: £1,451m) on privatisation.

27 Notes to the cash flow statement

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Operating profit from operations	2,278	468	2,298	468
Adjustments for:				
Depreciation of the railway network	1,086	964	1,086	964
Amortisation of capital grants	(31)	(26)	(31)	(26)
Amortisation of intangible assets	2	2	–	–
Decrease in provisions	(6)	(22)	(6)	(22)
Operating cash flows before movements in working capital	3,329	1,386	3,347	1,384
Increase in inventories	(5)	(9)	(5)	(9)
(Increase)/decrease in receivables	(199)	142	(34)	115
Increase/(decrease) in payables	125	(195)	(29)	(159)
Cash generated from operations	3,250	1,324	3,279	1,331
Interest paid	(822)	(669)	(819)	(669)
Net cash generated from operating activities	2,428	655	2,460	662

Cash and cash equivalents (which are represented as a single class of assets on the face of the balance sheet) comprise cash at bank and money market deposit investments with an average maturity of 2 days (2006: 3 days).

28 Analysis of changes in net debt

	At 1 April 2006 £m	Cash flows £m	Non cash movements £m	Amortisation of discount £m	Fair value remeasurements £m	Foreign exchange differences £m	At 31 March 2007 £m
Cash and cash equivalents	31	162	–	–	–	–	193
Borrowings due within one year	(4,186)	2,733	(1,502)	(80)	–	173	(2,862)
Borrowings due after one year	(14,197)	(3,268)	1,459	(13)	105	199	(15,715)
Obligations under finance leases	(10)	–	–	–	–	–	(10)
Available-for-sale investments	161	(161)	–	–	–	–	–
	(18,201)	(534)	(43)	(93)	105	372	(18,394)

	At 1 April 2005 £m	Cash flows £m	Non cash movements £m	Amortisation of discount £m	Fair value remeasurements £m	Foreign exchange differences £m	At 31 March 2006 £m
Cash and cash equivalents	28	3	–	–	–	–	31
Borrowings due within one year	(5,122)	2,151	(1,059)	(104)	–	(52)	(4,186)
Borrowings due after one year	(10,708)	(4,379)	1,059	(11)	7	(165)	(14,197)
Obligations under finance leases	(10)	–	–	–	–	–	(10)
Available-for-sale investments	166	(5)	–	–	–	–	161
	(15,646)	(2,230)	–	(115)	7	(217)	(18,201)

29 Operating lease arrangements

The Group as lessee

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Minimum lease payments under operating leases recognised in income statement in the year	38	54	38	54

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

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Within one year	36	43	36	43
In the second to fifth years inclusive	64	54	64	54
After five years	48	35	48	35
	148	132	148	132

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

The Group as lessor

Operating lease rentals earned in the year was £516m (2006: £479m). The majority of this income is earned from station and depot leases to train operating companies. Further rentals are earned from investment properties, other station lettings, advertising, telecoms and rail contractors.

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

	2007 Group £m	2006 Group £m	2007 Company £m	2006 Company £m
Within one year	420	375	420	375
In the second to fifth years inclusive	1,188	942	1,188	942
After five years	1,667	1,337	1,667	1,337
	3,275	2,654	3,275	2,654

30 Retirement benefit scheme

Defined contribution schemes

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

At 31 March 2007, the NRDCPS has 8,495 members (2006: 6,510) and the average employer contribution rate in the year was 5.6% (2006: 5.0%).

Defined benefit schemes

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

The assets transferred to the RPS from the BRPS on 1 October 1994 were apportioned 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.

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

A full actuarial valuation of the Network Rail Section was carried out by the scheme actuary at 31 December 2004. Qualified actuaries Watson Wyatt have valued the scheme on an IAS19 basis at 31 March 2007 and 31 March 2006.

30 Retirement benefit scheme continued

The total contribution rate payable under the RPS is normally split in the proportion 60:40 between the Group and the members. The Group reflects its share of the contribution in the financial statements.

The Group and members pay contributions of 15.51% (2006: 14.25%) and 10.34% (2006: 9.5%) of section pay respectively as at 31 March 2007.

If a surplus or deficit arises, the provisions in the RPS rules mean that the Company and members benefit from or pay for this respectively in the proportion 60:40.

	2007 %	2006 %
Key assumptions used:		
Discount rate	5.40	5.00
Expected return on equity assets	8.00	8.00
Expected return on bond assets	4.40	4.00
Expected return on property assets	6.20	6.00
Expected rate of salary increases*	4.70	4.50
Future pension increases	3.20	3.00

* Inclusive of a promotional salary scale of 0.5% per annum.

	2007		2006	
	Males	Females	Males	Females
Average life expectancy for mortality tables used to determine defined benefit obligations:				
– Member aged 65 now	17.8	20.1	17.8	20.1
– Member aged 65 in 20 years' time	18.7	21.2	18.7	21.2

Amounts recognised in income in respect of the Group's pension arrangements are as follows:

	2007 £m	2006 £m
Current service cost	121	115
Interest cost	102	92
Expected return on scheme assets	(119)	(71)
Past service costs	–	–
	104	136

The current service cost has been included in employee costs, the expected return on scheme assets less interest on liabilities has been included in finance costs.

Actuarial gains and losses have been reported in the statement of recognised income and expense.

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

	2007 £m	2006 £m
Present value of defined benefit obligations	(3,424)	(3,234)
Fair value of scheme assets	3,010	2,635
Deficit in the scheme	(414)	(599)
Company's share (60%) of the scheme deficit recognised in the balance sheet	(248)	(359)

This amount is presented in the balance sheet as follows:

	2007 £m	2006 £m
Included in current liabilities	–	–
Included in non-current liabilities	(248)	(359)
	(248)	(359)

Cumulative gains or losses are recognised in equity.

Movements in the present value of defined benefit obligations (including members' share) in the current year were as follows:

	2007 £m	2006 £m
At 1 April	(3,234)	(2,527)
Current service cost	(188)	(178)
Interest cost	(169)	(153)
Actual benefit payments	56	(150)
Actuarial gains and losses	111	(226)
Past service cost	–	–
At 31 March	(3,424)	(3,234)

30 Retirement benefit scheme continued

Movements in the present value of fair value of scheme assets (including members' share) in the current year were as follows:

	2007 £m	2006 £m
At 1 April	2,635	1,849
Expected return on scheme assets	198	118
Actuarial gains and losses	87	376
Contributions from scheme members	54	53
Contributions from Employer	92	89
Actual benefit payments	(56)	150
At 31 March	3,010	2,635

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

	Expected return		Fair value of assets	
	2007 %	2006 %	2007 £m	2006 £m
Equity instruments	8.00	8.00	2,332	2,131
Debt instruments	4.40	4.00	372	312
Property	6.20	6.00	296	174
Other	4.20	4.00	10	18
			3,010	2,635

The expected return on assets assumption was determined as the average of the expected returns on the assets held by the Network Rail Section on the accounting date. The rates of return for each class are set out in the table above and were determined as follows:

- Equities and property: The rate adopted is consistent with the median assumption used in Watson Wyatt's Asset Liability Modelling work.
- Bonds: The overall rate has been set to reflect the yields on the bond holdings.
- Other assets: This class is mostly made up of cash holdings and the rate adopted reflects current short-term returns on such deposits.

The history of experience adjustments is as follows:

	2007 £m	2006 £m	2005 £m
Present value of defined benefit obligations	(3,424)	(3,234)	(2,527)
Fair value of scheme assets	3,010	2,635	1,849
Deficit in the scheme	(414)	(599)	(678)
Company's share (60%) of the scheme deficit recognised in the balance sheet	(248)	(359)	(414)
Experience adjustments on scheme liabilities Amount (£m)	(14)	(67)	(217)
Percentage of scheme liabilities	0.41%	2.07%	8.59%
Experience adjustments on scheme assets Amount (£m)	52	229	79
Percentage of scheme assets	1.73%	8.69%	4.27%

The estimated amounts of contributions expected to be paid by the Group and members to the scheme during the year ended 31 March 2008 are £104m and £56m.

31 Related party transactions

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

The Company considers its key management personnel to be its directors. Details of their remuneration can be found in the Directors' remuneration report (see page 22).

The Company's ultimate parent company and controlling entity is Network Rail Limited, a company limited by guarantee without shares. The Company's immediate parent company is Network Rail Holdco Limited. Both parent companies are incorporated in Great Britain and registered in England and Wales. The largest group of undertakings of which the Company is a member and for which group accounts are drawn up is Network Rail Limited. Copies of the parent companies' financial statements can be obtained by contacting the Group Company Secretary at 40 Melton Street, London NW1 2EE.

Company information

Calendar 2007/08

3 April 2007

Publication of 2007 Business Plan

24 May 2007

Preliminary results announcement for full year to 31 March 2007

18 July 2007

Annual General Meeting of Network Rail Limited

November 2007

Results for half year announcement to 30 September 2007

