Annual efficiency and finance assessment of Network Rail 2024

Annex B: Link between efficiency and financial performance

A.1 Several measures can be used to report on a company's financial performance and there is no single right or wrong measure. The measures are not exclusive and can be complementary to provide a more rounded assessment. Our assessments focus on two measures: efficiency and the financial performance measure (FPM).

A.2 Consistent with general use in economic regulation, we use the term 'efficiency' to refer to changes over time of the cost of Network Rail's core business activities. These are Network Rail's activities of operating, maintaining, and renewing the rail network, and supporting functions such as human resources and finance. These are broadly repeatable activities, which makes them easier to compare over time.

A.3 We use the term 'financial performance' to assess both core business activities and wider activities that generate income (such as property income) and expenditure (such as enhancements to the network). Financial performance is a comparison of income and expenditure to the financial assumptions in a baseline such as in a business plan or regulatory determination. Other things being equal, if Network Rail has achieved the expected level of efficiency improvements in a business plan, it will report neither out nor under-performance against that plan. However, in practice, other things do result in differences between the reporting of efficiency and FPM. These include:

1. Items of income and expenditure that are included in FPM but not efficiency reporting,

such as interest payments or insurance costs.

2. External factors that can result in cost increases ('headwinds') and cost decreases ('tailwinds') such as changes to employment legislation which are outside of Network Rail's control. These external factors are reported separately to efficiency. However, these are all considered for FPM, so, for example, a headwind will negatively affect FPM (but not efficiency).
3. FPM adjusts for future cost increases resulting from business decisions made during the current financial year. For example, the costs of a major re-signalling project may be expected to increase in the next financial year due to a purchase decision made during the current financial year. This will result in negative financial performance being reported during the current financial year (consistent with the accruals accounting concept). Efficiency reporting does not adjust for this.
4. The additional cost of any changes to planned renewals work during a year are recorded as negative FPM, whereas the cost of the work avoided is recorded as FPM neutral. This is because FPM measures performance against the delivery plan and is designed to discourage regions from making late changes to planned work during the year.

A.4 Further information on efficiency and financial performance can be found in our CP6 regulatory accounting guidelines.

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