CP6 regulatory accounting guidelines for Network Rail

December 2019

Contents

1. Overview

Introduction

1.1 These regulatory accounting guidelines are issued pursuant to the network licence held by Network Rail Infrastructure Limited (‘Network Rail’). They set out the information that Network Rail is required to provide to us through annual regulatory financial statements in Control Period 6 (CP6), the five-year period from April 2019 to March 2024.

1.2 Good quality financial information is important for effective regulation as it helps ensure that the interests of customers and funders are properly protected. Network Rail’s regulatory financial statements are the primary sources of information about Network Rail’s financial performance that we consider are required for us to fulfil our statutory duties and functions and to inform stakeholders about these matters. They facilitate:

a) monitoring of efficiency and wider financial performance against the assumptions underlying our periodic review determinations;

b) assessment of financial position including the regulatory asset base and debt;

c) monitoring of capital investment; and

d) future periodic reviews and other regulatory decisions.

1.3 This information is more relevant for regulatory purposes than the information contained in statutory financial statements. This is because the statements are set out in a format consistent with our relevant policies and regulatory framework. By contrast, statutory financial statements are prepared in accordance with the requirements of the Companies Act 2006 and relevant statutory financial reporting standards.

1.4 These guidelines have been developed in consultation with Network Rail following a wider consultation on our CP6 approach to assessing Network Rail’s financial performance that we undertook as part of PR18. We have sought to make sure that the information that we require is proportionate to fulfil our duties without placing an undue burden on Network Rail. We have taken account of good practice from other economically regulated sectors.

1.5 These guidelines may be periodically revised and updated in CP6 to reflect developments in our regulatory framework.

2. Components of the regulatory financial statements

2.1 Network Rail is required under its network licence to provide us with the following information for each relevant twelve-month period ending 31 March:

a) regulatory financial statements;

b) a statement on the sufficiency of resources; and

c) as appropriate, relevant reports prepared by its auditors and independent reporters.

Contents of the regulatory financial statements

2.2 The regulatory financial statements will include the following:

a) a directors' review of the company's efficiency and wider financial performance in the year and cumulatively compared to the PR18 assumptions;

b) a statement of directors' responsibilities;

c) a statement of accounting policies;

d) statements on income, expenditure, financial performance, financial position and related matters as set out in these guidelines. Each statement should be supported by explanations of differences compared to the previous year and differences compared to Network Rail's CP6 delivery plan[1]. These statements should be provided for Great Britain, England and Wales, Scotland, each region, and Wales where appropriate[2];

e) any other supporting information that Network Rail considers necessary to fairly present its performance; and

f) sign-off by a director that Network Rail's Board has approved the regulatory financial statements having applied appropriate levels of assurance to ensure the accuracy of the information in the statements.

2.3 If there is a difference between the regulatory financial statements that have been submitted and the requirements of these guidelines, Network Rail must inform us. We will then consider whether or not to require modifications to be made to the information submitted.

2.4 After discussions with Network Rail, we have developed supporting templates for these guidelines. The templates provide guidance to Network Rail about the format of the

[1] Which reconciles back to the PR18 financial assumptions.

[2] After PR18 was finalised, Network Rail decided to change its regional operations from eight routes to 13 routes supported by five regions. For simplicity's sake, we have chosen to use consistent language with our PR18 determination in these guidelines with the term 'route' being interchangeable with the term 'region'. See https://www.networkrail.co.uk/who-we-are/putting-passengers-first/. Wales was previously a separate route and now forms part of the Wales and Western region.

regulatory financial statements. Network Rail can present the required information in a different format provided that any changes have previously been agreed with us.

Delivery and publication

2.5 The network licence requires that Network Rail delivers its regulatory financial statements to us as soon as reasonably practical and in any event not later than 1 July following the end of the relevant financial year unless a later date has been approved by us. Unless we have agreed otherwise, Network Rail should publish its regulatory financial statements on the same date.

2.6 An electronic version of the statements should be provided to us in a spreadsheet that clearly shows the flow of information and details of calculations within the statements.

Managing change

2.7 Our managing change policy for CP6[3] requires Network Rail to discuss with us any planned significant changes to the requirements of our PR18 final determinations for each region. The impact of financial changes should be made clear in the regulatory financial statements, for example, where any funding baselines are different to the CP6 delivery plan.

Quality of reporting

2.8 In order for us to make informed assessments, we need to have confidence that the information contained within Network Rail's regulatory financial statements is accurate and reliable. Network Rail must therefore be able to demonstrate that properly documented records support the regulatory financial statements and that the reporting systems and processes are fit for purpose. This includes being able to demonstrate that an adequate number of fully trained individuals are responsible for reporting and appropriate levels of verification have been applied.

2.9 In general, the basis of preparation of the statements should satisfy the following criteria:

- information should be presented on a consistent basis over time;
- accounting policies should be fair and reasonable, and applied consistently and objectively;
- the high-level principles and income and cost allocation rules as set out in these guidelines should be followed; and
- the value of the Regulatory Asset Bases ('RABs') in the regulatory financial statements should be consistent with the basis adopted for our PR18 determination.

[3] See http://orr.gov.uk/__data/assets/pdf_file/0008/39329/pr18-managing-change-policy.pdf.

2.10 The numbers produced are expected as a minimum to be accurate to within ±5%. In some cases we expect the numbers to be more accurate than this, for example, the amount of network grant received by Network Rail. This evidence on the reporting systems and processes must be provided to us before any outperformance can be recognised, unless otherwise agreed with us.

2.11 Unless otherwise agreed with us, monetary amounts should be presented in £m to zero decimal places. Percentages and ratios should be presented to one decimal place.

Indexation

2.12 Indexation adjustments to the CP6 delivery plan baselines and previous year numbers should be applied for movements in the CPI index. The percentage change for the relevant year 20XX/YY should be calculated by:

- subtracting the value of the CPI index published by the Office for National Statistics for November in the preceding year from the equivalent value for November in the relevant year (20XX/YY);
- dividing the resulting value into the index value for November in the preceding year; and
- expressing the result in percentage form.

2.13 For example, if the CPI index was at 260 in 20XX/YY and 250 in the previous year, then the percentage change would be:

$$\text{CPI percentage change} = \frac{260-250}{250} = 0.04 \quad = 4.0\%$$

Statement of sufficiency of resources

2.14 The network licence requires Network Rail to act in a manner calculated to ensure that it has sufficient resources to enable it to properly and efficiently carry on its permitted business. It also requires Network Rail to make a statement, approved by a resolution of its Board of Directors, certifying the sufficiency of its resources for a twelve-month period commencing on the date of the statement. The purpose of the statement of sufficiency of resources is to provide us and other interested parties with assurance about the future financial position of Network Rail.

2.15 The prescribed formats for the statement of sufficiency of resources are set out in Annex C.

2.16 An auditors’ report on the statement of sufficiency of resources should be submitted along with the statement of sufficiency of resources at the same time as the regulatory financial statements.

Role of the auditors and independent reporters

2.17 The network licence requires Network Rail to obtain reports from its auditors on certain statements in the regulatory financial statements and its statement on the sufficiency of its resources.

2.18 The format for the auditors' report will be set out in a terms of engagement letter. This letter forms part of the contract of appointment with the auditors, which Network Rail is required to obtain under the network licence. The auditors' report will be addressed to ORR and state whether, in the auditors' opinion, the regulatory financial statements present fairly the financial performance and financial position of Network Rail and whether they have been prepared in accordance with these guidelines. The report should identify any material circumstances or areas of judgement that appear to be relevant.

2.19 Unless agreed by us, the auditors' report should cover each of the regulatory financial statements. Network Rail may use independent reporters to review some of the information in the regulatory financial statements[4]. This will complement the work of the auditors.

Appendix to the regulatory financial statements

2.20 All details reasonably necessary to reconcile items included in the regulatory financial statements with similar items in the statutory financial statements should be included in an appendix to the regulatory financial statements.

2.21 In particular, the appendix should enable a comparison of the:

a) income and expenditure reported in the statutory financial statements to the income and expenditure reported in the regulatory financial statements; and

b) annual movement in the fixed assets reported on the balance sheet with the movement in the value of the RAB.

[4] Independent reporters are industry experts that can be jointly appointed by ORR and Network Rail to provide advice and assurance on regulatory matters. They have a duty of care to both ORR and Network Rail.

3. Efficiency and financial performance

Introduction

3.1 Different measures can be used to report on a company's financial performance and there is no single right or wrong measure. Different measures are not exclusive and can be complimentary to provide a more rounded assessment. We consulted on these matters in the development of our PR18 determination[5].

3.2 Our assessments in CP6 focus on two measures:

- **Efficiency**: This compares the relationship between expenditure on core business activities (operations, maintenance, renewals and supporting functions) and outputs on a like-for-like basis over time.

- **Financial performance**: This compares income and expenditure to the financial assumptions underpinning regions' CP6 funding. The baseline financial assumptions include the efficiency improvements that Network Rail's regions are expected to achieve in CP6. As such, these baselines are described as being post-efficient. If a region has spent less and / or has received more income than the baseline (for what it has delivered), it will report financial outperformance, and vice versa.

3.3 Reporting of efficiency and financial performance over time gives assurance to rail users and funders that Network Rail's regions are delivering what is expected and at the same time, provides a reputational incentive for them to become more efficient.

3.4 The priorities for our assessments, and hence for Network Rail's reporting in CP6 are to:

- drive the best outcomes for the users of the rail network through supporting better value for money;

- enhance comparisons of the performance of regions and to assist in future benchmarking;

- move away from measures that aim to be technically precise to a more rounded assessment which draws out key messages about the drivers of performance, makes a clearer link between expenditure and delivery, and examines how efficiencies are being achieved;

- make more informed forward-looking assessments of the efficiencies that regions will likely deliver across the control period;

[5] See http://orr.gov.uk/rail/consultations/open-consultations/our-approach-for-assessing-network-rails-efficiency-and-wider-financial-performance-in-control-period-6.

- support Network Rail’s internal performance measurement and staff incentives; and
- provide clear and informative messages about efficiency improvements, recognising that different audiences want different levels of technical detail.

3.5 To deliver these priorities we have made the following changes for Network Rail’s reporting in CP6:

- greater emphasis on reporting of how regions have delivered efficiency improvements;
- more assessment of cost drivers and productivity measures over time and across regions; and
- forward-looking view of the efficiencies that Network Rail will likely achieve across CP6. This will include reporting on the progress of regions’ efficiency plans and leading indicators of delivery.

Efficiency, inefficiency, headwinds and tailwinds

3.6 Analysis of the reasons for expenditure changes over time is an important component of understanding a company’s financial performance.

3.7 Regions should quantify and clearly explain the factors that have affected their changes to expenditure. This analysis should include the effectiveness of efficiency initiatives compared to those set out in their CP6 business plans[6] and the effects of other cost drivers including inefficiencies and factors considered to be outside of regions’ control (headwinds and tailwinds).

3.8 Unless we decide otherwise, the basis for reporting efficiency in CP6 should be consistent with the approach used in PR18, i.e. the £3.5bn of efficiency improvements that Network Rail is required to deliver in CP6.

3.9 Network Rail used the terms ‘headwinds’ and ‘tailwinds’ to describe external uncontrollable cost changes in its business planning for CP6. Examples in Network Rail’s CP6 strategic business plans included changes to its fatigue management policy and increased cost of access to third party land. We had a different view on some of these headwinds which was reflected in our PR18 determination. Ultimately, Network Rail’s regulatory financial statements are required to use our interpretation of efficiency, inefficiency, headwinds and tailwinds

[6] If these plans are consistent with the PR18 determination and changes agreed through the managing change process.

Supporting analysis

a) Unit costs

3.10 Movements in unit costs are a useful way to understand changes to the economy and productivity of repeatable activities such as maintenance and renewals. Unit cost analysis is well established in many industries and it is relatively easy for stakeholders to understand.

3.11 Network Rail's renewals projects are not uniform in nature because of factors such as the geographic location and differing nature of the work at each site. This means that the cost of specific projects may vary for reasons other than efficiency. However, the effect of these factors should be much reduced when comparing entire programmes of work over time. This is because there will be variations within programmes but, due to aggregation, there should be less variation across programmes as a whole.

3.12 We consider that for most of Network Rail's maintenance and renewals activities it should be possible to identify and record the main factors that lead to cost differences across programmes of work over time. It should then be possible to quantify unit cost changes due to efficiency changes and due to other reasons.

3.13 We require Network Rail and its regions to report the unit costs and volumes of work for each of the company's main renewals activities. Network Rail will also need to continue to develop its management information systems to support robust maintenance unit cost and volume reporting in CP6.

(b) Productivity measures

3.14 Improving productivity is one of the key ways for a company to become more efficient. However, we have made little use of productivity measures in our monitoring of Network Rail's efficiency in previous control periods.

3.15 We could prescribe the measures that we use to assess Network Rail's productivity improvements. However, we recognise that this information should also be important for Network Rail's own management. We therefore want Network Rail's year end reporting to include the productivity measures that it considers most suitable for helping to inform understanding of changes to its efficiency over time[7]. As this information should already be available, we do not consider that reporting it to us should be a burden on the company.

[7] Examples could include time on tools for maintenance workers and volume of high output track renewal per overnight shift.

Forward looking assessment

3.16 Our experience in CP5 was that Network Rail was over-optimistic about the efficiency improvements that it could achieve and that this over-optimism remained through most of the company's financial forecasts during the control period.

3.17 To address this issue, our CP6 annual efficiency and finance assessments will include a forward-looking assessment. This should give greater confidence about whether Network Rail's regions are on track to deliver the efficiencies that are set out in the CP6 strategic business plans. This will also assist the Governments' monitoring arrangements.

3.18 Our forward-looking assessments will be a rigorous process of challenging regions about the progress of their initiatives to deliver efficiency improvements. To support our assessments, regions will need to have well documented plans for how they intend to deliver efficiency improvements and clear tracking of progress in delivering these plans.

3.19 There are leading indicators of performance that we can also draw on to provide our independent view about the efficiency improvements that Network Rail is likely to achieve by the end of CP6. For example, the proportion of work that has been tendered would help us to understand the stability of planned work and certainty of associated cost. These indicators will enable us to report our confidence about Network Rail's forecast efficiency improvements.

3.20 We could prescribe the indicators that we intend to use. However, we recognise that this information should also be useful for Network Rail's own management and that much of it should already be available. We therefore want Network Rail to report the indicators that it considers most suitable[8].

Financial performance

3.21 In CP6, we will monitor the financial performance of regions' income and expenditure compared to Network Rail's CP6 delivery plan. This will generate either an aggregate underspend, i.e. a region has spent less than we assumed was necessary to deliver its required outputs, or an aggregate overspend, i.e. it has spent more than we assumed was necessary to deliver its required outputs.

3.22 Financial performance should be calculated as follows for each region:

a) categories of income and expenditure that are not controllable should be excluded from the calculation. The major categories are set out in Table 3.1;

[8] Network Rail has already started to provide leading indicators, which we have reported on in our recent Network Rail Monitor publications. See https://orr.gov.uk/rail/economic-regulation/regulation-of-network-rail/monitoring-performance/network-rail-monitor.

b) income and expenditure in annual business plans should be compared to the CP6 delivery plan, adjusted for inflation. The reasons for variances should be explained;

c) for all other categories, actual income and expenditure should be compared to the annual business plan / budget. The reasons for variances should be explained;

d) the output from steps (b) and (c) should be combined to produce an aggregate comparison of actual income and expenditure to the CP6 delivery plan for the year; and

e) the same calculation should be performed for the cumulative financial performance in CP6.

Table 3.1: The major items of income and expenditure that are excluded from the financial performance measure

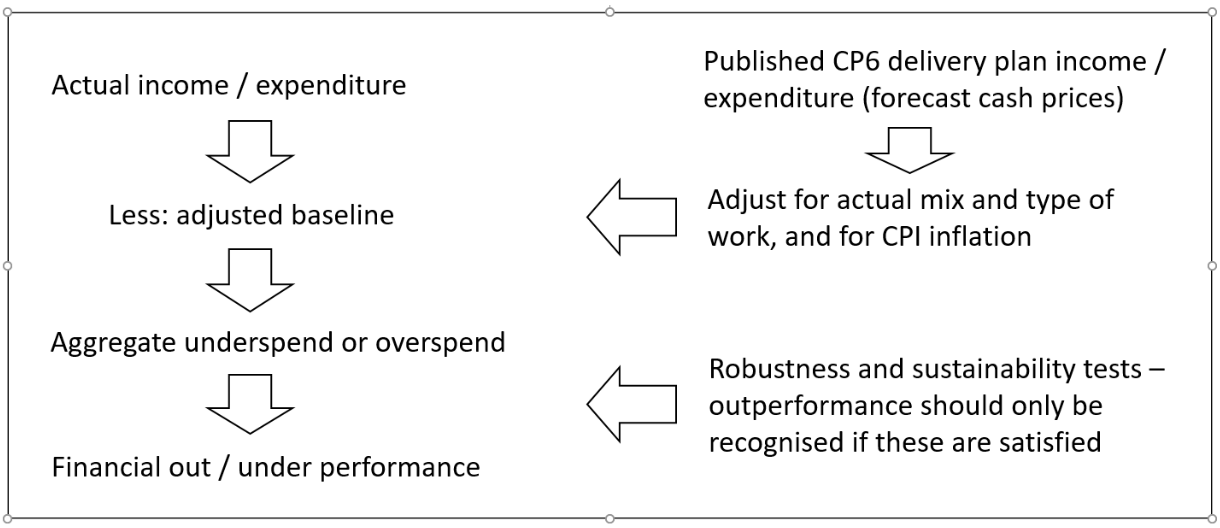
Financial performance does not include
Grant income
Fixed track access charges
Traction electricity income received from train operations
Traction electricity costs paid on behalf train operators
Business rates
Licence and safety fees
Rail Safety and Standards Board ('RSSB') costs
Auditors and reporters' fees

3.23 In determining its financial performance, each region will need to assess whether it has delivered the outputs specified in our PR18 determination. We define this as the 'robustness' test. It will also need to assess whether it has done enough maintenance and renewal work to counter the wear, degradation and ageing of its assets over time. This is to ensure that the condition and performance of the network infrastructure is sufficient to enable the PR18 outputs to be achieved for the forecast level and mix of use in the medium and long term. We define this as the 'sustainability' test.

3.24 The burden of proof is on Network Rail to show that any claimed financial outperformance is consistent with the robustness and sustainability tests. Network Rail will also need to explain how any underspend has been achieved. In the absence of such an explanation, underspend should not be assumed to represent financial outperformance.

3.25 Figure 3.1 summarises the approach for calculating FPM.

Figure 3.1 Approach for calculating FPM



Neutral expenditure variances

3.26 Income and expenditure can vary for reasons other than better or worse financial performance compared to the CP6 delivery plan. This is particularly relevant for renewals expenditure where an underspend may be due to planned work not being undertaken. Such expenditure variances need to be clearly reported alongside financial performance to enable a full understanding of income and expenditure variances. Annex B provides further guidance about the treatment of deferral and how Network Rail does not benefit if this happens.

Treatment of material one-off changes to Network Rail's income and expenditure

3.27 Our general approach is that if a category of income or expenditure is deemed controllable by Network Rail then it should be included in the reporting of financial performance. This applies to unforeseen material one-off changes (both positive and negative) that are deemed controllable.

3.28 However, we may consider material one-off changes on an individual basis as we do not want to incentivise Network Rail to make poor value for money decisions. For example, an exception to our general approach applies for a material buy or lease decision. Providing that Network Rail has adequately demonstrated that a change in a buy or lease decision is economically beneficial in the long term, we will hold Network Rail neutral to the financial performance impact of the change within the control period.

Regulatory financial sanctions

3.29 As set out in our Holding Network Rail to account policy[9], ORR's Board may decide to issue a financial sanction in response to a licence breach decision. The financial sanction would apply as a deduction in the reported financial performance (i.e. FPM) of the relevant Network Rail region. So the financial performance reported in Network Rail's regulatory financial statements, and therefore scorecards would include the financial sanction.

3.30 The amount of the deduction and the regions to which it applies will be directed by ORR.

Detailed guidance for the calculation of financial performance

3.31 Detailed guidance for the calculation of financial performance is set out in Network Rail's internal FPM guidance[10]. Consistent with our approach in CP5, we consider that it is right for the technical details to be set out in Network Rail's internal guidance. However, our requirements, as may change from time to time, override Network Rail's internal guidance and must be followed. For example, if Network Rail was to make changes to its internal guidance that we do not agree with, we will instruct Network Rail on how it should report in its regulatory financial statements.

[9] See https://orr.gov.uk/rail/economic-regulation/regulation-of-network-rail/holding-network-rail-to-account.

[10] Network Rail's guidance is set out in an internal FPM handbook. This currently comprises 11 documents covering the treatment of FPM for its business activities.

4. Regulatory Asset Base (RAB)

Introduction

4.1 This chapter sets out our policies relating to the reporting of the Regulatory Asset Base (RAB). It outlines the background, general approach and specific policies relating to RAB roll forward, renewals and enhancements expenditure, and amortisation.

General approach

4.2 In CP6, the RAB is calculated as the CP5 closing RAB:

- plus an inflation adjustment to the opening RAB;
- plus efficient renewals and enhancements expenditure; and
- less amortisation[11].

4.3 The assessment of the RAB is a cumulative assessment for CP6, for example, an overspend in year one would be offset by underspend in year two. This means that it will only be possible to finalise the value of the RAB once CP6 is completed. All annual calculations of the RAB during CP6 in the regulatory financial statements will therefore be provisional.

Process for calculating renewals additions to the RAB

4.4 The process for determining whether Network Rail has underspent or overspent our PR18 renewals assumption is firstly to calculate the baseline determination by uplifting the PR18 renewals assumption to the price base in the relevant year as described in Chapter 2.

4.5 The inflated baseline number should then be adjusted for any deferral or acceleration of expenditure.

4.6 Any underspend against this baseline will be deemed efficient as long as Network Rail has met the robustness and sustainability tests described in Chapter 3.

4.7 If there is an overspend, Network Rail will need to demonstrate that the overspend is not manifestly inefficient. Manifestly inefficient renewals expenditure does not meet the following criteria:

a) within the scope of the network licence;

[11] As set out in our PR18 financial framework document, the amortisation will ordinarily be the same as renewals expenditure incurred in CP6. Enhancements expenditure will ordinarily be cash funded and so not added to the RAB.

b) within the scope of the DfT and Transport Scotland HLOS requirements (if relevant);

c) meets a customer reasonable requirement; or

d) adds economic value to the railway.

4.8 We would expect a key element of Network Rail's justification that renewals expenditure is not manifestly inefficient would be evidence that internal project management and investment authorisation controls had been properly applied.

Process for calculating enhancements additions to the RAB

4.9 We currently anticipate that all DfT and Transport Scotland specified enhancements will be government grant funded in CP6. This means that we do not anticipate any RAB additions for enhancements expenditure in CP6.

Treatment of asset disposal proceeds

4.10 RAB deductions should be valued as an amount equal to actual sales proceeds because of the objectivity/transparency associated with this approach (but subject to the possibility of bespoke treatment in exceptional circumstances)[12].

Presentation of the RAB in the regulatory financial statements

4.11 Regions' regulatory financial statements will include a statement summarising the changes to the RAB during the year.

Investments approved by ORR through the investment framework

4.12 The investment framework provides a means for infrastructure projects to be approved, specified and delivered outside of the periodic review process[13]. This may be because of, for example, changing safety requirements, newly developed enhancements to improve Network Rail's performance, or customer requirements for additional outputs. Where appropriate these schemes are added to the RAB.

[12] See Chapter 4 of the PR18 financial framework supplementary document for further details. An example of bespoke treatment might be the disposal of assets by Network Rail to Transport for Wales as part of the process of devolving responsibility for the core valley lines. In this case, we have referred to a depreciated replacement value as a starting point for ascertaining a value for the assets concerned.

[13] The investment framework is the framework for investments outside of the periodic review. The 'investment framework consolidated policy & guidelines' document is available at https://orr.gov.uk/rail/investing-in-the-rail-network/the-investment-framework.

4.13 The investment framework classifies investment schemes and our approvals process from the perspective of the three main types of investors:

a) third party investors;

b) franchised operators; and

c) governments.

4.14 Efficient expenditure on schemes promoted by these investors can be logged up by Network Rail for inclusion in the RAB, subject to the criteria set out in the investment framework.

4.15 The investment framework allows Network Rail to recover its capital and financing costs for certain schemes through charges, for example, facility charges. In such cases, capitalised financing will not normally need to be added to the RAB. Facility charges generally include two components (a) a financing charge element and (b) an amortisation element.

4.16 Where the facility charges from the scheme include a recovery of the scheme capital costs, amortisation will be deducted from the RAB. The amortisation adjustment in this instance only includes the amortisation element and not the financing charge element of the facility charge. The amortisation element will be deducted from the RAB until the end of the control period (in which the scheme is added to the RAB). This will ensure that Network Rail does not over recover its costs.

4.17 Where Network Rail does not receive charges from schemes to reimburse it for its financing costs in accordance with the investment framework, capitalised financing on the efficient costs should be logged up to the RAB.

Annex A: Required statements and disclosures

The required statements and disclosures in Network Rail's regulatory financial statements are included in the spreadsheet: 'Template regulatory financial statements for CP6', which is available on the ORR website.

Annex B: Guidelines for preparing the regulatory accounts

General

1. Network Rail should apply the following guidelines when preparing its regulatory financial statements.

2. The following high-level principles should be applied when preparing the regulatory financial statements:

   (a) **Causality:** Income and expenditure should be allocated in relation to the activities which cause the income to be earned or the expenditure to be incurred;

   (b) **Objectivity:** The regulatory financial statements should be prepared without unduly prejudicing Network Rail or any part of Network Rail or any other entity;

   (c) **Consistency:** The regulatory financial statements should be prepared on a consistent basis from year to year. Where there are changes, the previous year's regulatory financial statements will be restated on a consistent basis; and

   (d) **Transparency:** The methods used to prepare the regulatory financial statements should be made clear.

3. Unless we agree otherwise, income and expenditure should be recorded on the same basis as they were treated in the PR18 determination, using the same definitions of activities as Network Rail's PR18 submissions.

4. If the basis of allocating income or expenditure between income or expenditure sub-categories changes, the change should be disclosed in the narrative to the regulatory financial statements.

Income

5. Total income consists of franchise access income, grant income and other single till income.

6. Other single till income includes the following:

   (a) property income - revenue generated from Network Rail's non-operational property portfolio, including the proceeds of disposals and any adjustments for commercial operational expenditure;

   (b) freight income - net income from track and other charges paid by freight train operators;

(c) open access income - net income from track and other charges paid by passenger train operators not operating under any form of franchise agreement;

(d) stations income - net income from station access agreements (for managed stations and franchised stations);

(e) depots income - net income from depot access agreements;

(f) finance and facility charges;

(g) income from operating the HS1 concession; and

(h) other.

Expenditure

Maintenance and renewals

7. Maintenance expenditure relates to activities that counter the wear, degradation or ageing of the existing infrastructure so that the required standard of performance is achieved.

8. Maintenance expenditure generally includes:

   (a) expenditure incurred in repairing (but not replacing) infrastructure assets and routine over-hauls;

   (b) the cost of preventative work designed to protect assets from future failure;

   (c) the cost of asset inspection; and

   (d) the cost of all small-scale replacement work excluded from the definition of renewals expenditure.

9. Renewals expenditure relates to activities where an existing infrastructure asset has deteriorated so that it can no longer be maintained economically but has to be replaced as a whole or in part. Such expenditure does not result in any change or enhancement of the performance of the original asset.

10. Network Rail’s Cost and Volume handbook defines the accounting treatment (i.e. maintenance or renewal) for specific asset interventions.

Treatment of financial performance versus neutral expenditure variances including deferral

11. Maintenance and renewals expenditure can vary for reasons other than better or worse financial performance compared to the CP6 delivery plan. The following are relevant examples for the reporting of financial performance and neutral expenditure variances:

- **Slippage of work due to poor weather**: Work planned to be undertaken near to the end of one year may be postponed to the next year due to poor weather restricting site access. The resulting underspend is not financial outperformance as the output in the CP6 delivery plan has not been delivered. If the work is subsequently caught up and there has been no impact on the robustness or sustainability of the network, the underspend in the first year should therefore be treated as neutral (deferral) in the reporting of financial performance. If the cost of undertaking the work subsequently increases because of the delay, the additional cost will be reported as financial underperformance when that work is undertaken.

- **Change in usage**: A change in usage on a part of the network might lead to more or fewer renewals being required than included in the CP6 delivery plan. For example, if a decrease in freight traffic no longer requires a siding to be renewed. The resulting underspend is not financial outperformance as the output in the CP6 delivery plan has not been delivered. However, there has been no impact on the robustness or sustainability of the network as the output in the CP6 delivery plan is no longer required, so there is no financial underperformance. The underspend should therefore be treated as neutral in the reporting of financial performance.

- **Change in asset knowledge**: Better asset information or a change in asset policy might result in more or less work being required than that which was included in the CP6 delivery plan. For example if improved asset information shows that asset condition is better than previously thought, less work can be undertaken to maintain the robustness and sustainability of the network. The resulting underspend should be treated as financial outperformance as the same output has been delivered for less than the CP6 delivery plan. Conversely, new asset information may show that asset condition is worse than previously thought. This would require more work to maintain the robustness and sustainability of the network. The resulting overspend should be treated as financial underperformance as the required output has cost more than the CP6 delivery plan.

- **Repackaging of work**: Network Rail may identify an opportunity to repackage renewals so that the work can be delivered more efficiently as a whole, for example, by coordinating possessions to minimise network disruption. In the situation where work is delayed, the underspend is not financial outperformance as the work still needs to be undertaken. The underspend should be treated as a neutral deferral providing the delay to the work being undertaken does not affect the robustness or sustainability of the network. When the repackaged work is undertaken, financial outperformance will be reported, assuming that the expected benefit (lower cost) has been achieved.

12. Such expenditure variances need to be clearly reported alongside financial performance to enable a full understanding of income and expenditure variances.

Enhancements

13. Enhancement expenditure is incurred to undertake activities to improve capacity or capability of the rail network. Expenditure on enhancements to the network must be separately reported from expenditure on renewals to the network.

Regional reporting

14. Network Rail's income and expenditure are classified into the following three main categories dependent upon how the items are managed[14]:

(a) directly attributed. Income and expenditure in this category is managed at a region level. As there is a clear alignment between management responsibility and the region, such items are relatively straightforward to account for at a region level;

(b) centrally managed - attributable. Income and expenditure in this category is not managed at a region level, however, the income is earned and / or expenditure are incurred locally. Apportionment may be required for activities that span region; and

(c) centrally managed - network wide. Income and expenditure in this category is incurred for the network or company as a whole (for example, external insurance costs). These items are allocated to regions using a relevant metric.

15. The split across the above three categories should be made clear in regions' reporting of income and expenditure.

Network Rail (High Speed) Limited

16. HS1 Limited has contracted with Network Rail (High Speed) Limited for it to operate, maintain and renew the High Speed 1 line. Most of the resources that Network Rail (High Speed) Limited uses to carry out these activities are provided by Network Rail. Therefore, it is important that the charges that Network Rail makes to Network Rail (High Speed) Limited are transparent and cost reflective and that there is no cross-subsidy as these costs are not remunerated through Network Rail's access charges reviews.

[14] The accounting policies note to Network Rail's CP5 regulatory financial statements includes detailed definitions.

17. In order to help ensure that the charges are transparent and cost reflective, Network Rail will provide an up to date detailed description of its methodology for allocating/charging its costs to Network Rail (High Speed) Limited and will keep an up to date register of the assets that are being used to provide services to HS1 together with the methodologies used to recover the costs of those assets.

Annex C: Format of the statement of sufficiency of resources

The statement of sufficiency of resources shall be in one of the following forms:

(a) "After making enquiries, and subject to the outcome of any access charges review which is due to be concluded within the 12 month period referred to in this statement, the directors of the licence holder have a reasonable expectation that the licence holder will have available to it, after taking into account in particular, but without limitation:

   i. any dividend or other distribution, loan repayments or other sums due which might reasonably be expected to be declared or paid by the licence holder;

   ii. any mortgage, charge, pledge, lien or other form of security or other encumbrance; and

   iii. any indebtedness or guarantee;

sufficient resources, including (without limitation) management and financial resources, personnel, fixed and moveable assets, rights, licences, consents, and facilities, on such terms and with all such rights, to enable the licence holder to: (a) properly and efficiently carry on the Permitted Business; and (b) comply in all respects with its obligations under the Act and under its network licence, for the period of 12 months referred to in this statement."

or:

(b) "After making enquiries, and subject to the outcome of any access charges review which is due to be concluded within the 12 month period referred to in this statement, the directors of the licence holder have a reasonable expectation, subject to the factors set out below, that the licence holder will have available to it, after taking into account in particular, but without limitation:

   i. any dividend or other distribution, loan repayments or other sums due which might reasonably be expected to be declared or paid by the licence holder;

   ii. any mortgage, charge, pledge, lien, or other form of security or other encumbrance; and

   iii. any indebtedness or guarantee;

sufficient resources, including (without limitation) management and financial resources, personnel, fixed and moveable assets, rights, licences, consents, and facilities, on such terms and with all such rights, to enable the licence holder to: (a) properly and efficiently carry on the Permitted Business; and (b) comply in all respects with its obligations under the Act and under its network licence, for the period of 12 months referred to in this statement. However, they would like to draw attention to the following factors which may cast doubt on the ability of the licence holder to do this."

or:

(c) "In the opinion of the directors of the licence holder, the licence holder will not have available to it sufficient resources, including (without limitation) management and financial resources, personnel, fixed and moveable assets, rights, licences, consents, and facilities, on such terms and with all such rights, to enable the licence holder to: (a) properly and efficiently carry on the Permitted Business; and (b) comply in all respects with its obligations under the Act and under its network licence, for the period of 12 months referred to in this statement."

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