



OFFICE OF RAIL REGULATION

Regulatory Accounting Guidelines for Network Rail Infrastructure Limited

February 2012

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1. Overview

Introduction

- 1.1 These regulatory accounting guidelines ('the Guidelines') are issued pursuant to Condition 11 of the Network Licence ('Condition 11') held by Network Rail Infrastructure Limited ('Network Rail').¹ Network Rail's 2011-12 regulatory accounts will be prepared in accordance with these Guidelines.
- 1.2 Network Rail is the operator of the national railway network. Its main business is the operation, maintenance, renewal and enhancement of the national railway network. It is wholly owned by Network Rail Limited, a company limited by guarantee and owned by members rather than equity shareholders.
- 1.3 Network Rail's regulatory accounts are the primary source of audited information about the company's regulatory financial position and performance and are useful to the Office of Rail Regulation ('ORR'), funders and other interested parties for the purposes of informing the determination of access charges, monitoring compliance with our 2008 periodic review ('PR08') determination and informing the robust financial monitoring of Network Rail. Good quality accounting information is important for effective regulation and helps ensure that the interests of customers and funders are properly protected.
- 1.4 Our 2011-12 Guidelines have been updated to include the following key changes:
- (a) require Network Rail to publish audited financial information disaggregated by operating route as recommended by the McNulty Value for Money Study. We required Network Rail to provide this information on a shadow basis in 2010-11;
 - (b) provide greater detail about renewals and maintenance unit costs to better inform our 2013 periodic review;²

¹ See annex C for condition 11.

² For more information please see our letter responding to the independent evaluation and looking ahead to the 2013 periodic review. This may be accessed at <http://www.rail-reg.gov.uk/upload/pdf/pr13-orr-letter-291009.pdf>.

- (c) provide greater details about Network Rail's efficiency;
- (d) provide information about the Financial Value Added (FVA) measure which Network Rail has introduced this year as part of the Management Incentive Plan (MIP); and
- (e) provide more information about the composition and movements in Network Rail's net debt and derivative financial instruments.

1.5 Network Rail is required by Conditions 11.11 and 11.13 and Condition 3 of its network licence to provide us with the following information:

- the regulatory financial statements, with such information as may be provided for in the Regulatory Accounting Guidelines, (including the associated narrative explanation set out in more detail in chapter 2);
- a statement on the adequacy of its financial and management resources;
- reports prepared by its auditors on the regulatory financial statements and the statement on the adequacy of its resources; and
- a statement under Condition 3 of its network licence on its compliance with the limits on its financial indebtedness.

In these Guidelines, these documents are collectively described as “the regulatory accounts”.

1.6 The remainder of this chapter provides an overview of the purpose and key features of the regulatory accounts, and the background to the framework for preparing them.

Purpose of regulatory financial statements

1.7 Regulatory accounts are designed to provide information about Network Rail's regulated business for use by us, funders, lenders, customers and other stakeholders for the primary purpose of informing our access charges reviews and of monitoring Network Rail's performance against the assumptions underlying the most recent access charges review. The regulatory accounts provide information in special-purpose financial statements. This information is more relevant for regulatory purposes than the information contained in statutory accounts, as the statements are set out in a format consistent with

our relevant policies and the regulatory framework established in PR08. By contrast, statutory accounts are prepared as required by company law, and in accordance with the Companies Acts and either in accordance with UK Accounting Standards or in accordance with International Financial Reporting Standards and Article 4 of the IAS Regulation.

- 1.8 The regulatory accounts enable the following tasks to be carried out:
- monitoring financial performance against the assumptions underlying our PR08 determination;
 - informing future access charges reviews and other regulatory decisions that require financial information, such as information on expenditure thresholds for interim reviews of access charges;
 - assessing the financial position of the regulated business, in particular by reporting on the company's net debt and its RAB; and
 - monitoring ongoing capital investment (particularly enhancements) made by the company.
- 1.9 In developing these Guidelines, we have consulted with Network Rail and sought to minimise the regulatory burden on Network Rail.

Regulatory good practice

- 1.10 Other UK sector regulators require the companies they regulate to prepare annual regulatory accounts and provide other information for similar reasons to those set out above. This requirement is usually contained within the licences of the regulated companies. We have taken due account of good practice from other sectors in preparing these Guidelines.
- 1.11 The Department of Trade and Industry's ('the DTI's') Green Paper on utility regulation, *A Fair Deal for Consumers* published in 1998, suggested that there would be benefits if regulated companies were to produce more standardised regulatory accounts. In particular this would facilitate wider understanding of regulatory issues. Following the Green Paper, an inter-regulatory working group on regulatory accounts was set up to identify and develop areas of consistency within published regulatory accounts. We are a member of the working group and these Guidelines have been designed, in so far as

possible, to adopt the set of common regulatory accounting principles agreed by the working group.

1.12 The main elements of these high-level principles are:

- regulatory accounts will be prepared and audited using the common regulatory accounting framework devised by the working group. Where there are any conflicts between Regulatory Accounting Guidelines and any other Generally Accepted Accounting Practice, then the Regulatory Accounting Guidelines will take precedence;
- where practicable there will be consistency between the formats of the regulatory accounts used in the industries regulated by the members of the working group;
- where appropriate, actual performance will be compared to the assumptions underlying price controls;
- the requirements for the audit of the regulatory accounts will become more clearly defined (this is described in more detail in chapter 2); and
- regulatory accounts will be published no later than four months after the regulatory accounting year end; and, where appropriate, the regulatory accounts will include additional information that will enhance understanding of the regulated companies' performance.

1.13 Each regulator has a different emphasis in developing regulatory accounting arrangements depending on the structure of the industry that it regulates. Where there are significant differences between regulators, these derive primarily from the structure of the industry rather than from differences of principle.

1.14 For example, in the telecommunications industry, regulatory accounting arrangements are designed to reflect the development of competition and the importance of monitoring and detecting anti-competitive behaviour such as unfair cross-subsidisation and undue discrimination. In areas where there is currently little competition between networks, such as water and sewerage, the focus is on ensuring that regulatory accounting arrangements provide consistent and transparent financial information in order to monitor performance and support the resetting of price controls.

Accounting period

1.15 Network Rail is required to produce the regulatory accounts annually. All the regulatory financial statements cover a period of twelve months for the relevant year ending 31 March. From 1 April 2009, Network Rail's *Statement of the Adequacy of its Resources* also covers a period of 12 months looking forward from the date of signature of that year's regulatory accounts.³

Basis of preparation

1.16 A key requirement of the regulatory accounts is that Network Rail's financial position and performance are reported on a consistent basis over time. The baseline for comparison is our PR08 determination.

1.17 In general, the basis of preparation by Network Rail should also satisfy the following criteria:

- accounting policies applied by Network Rail should be fair and reasonable and applied consistently and objectively;
- the high-level principles and income and cost allocation rules as set out in annex B of these Guidelines should be followed; and
- the value of the RAB in the regulatory accounts should be consistent with the basis adopted for our PR08 determination.

Consolidation

1.18 The regulatory financial statements Network Rail is required to produce as licence holder "in relation to itself" in accordance with Condition 11 and the Guidelines shall relate only to the company itself, and shall not, without our agreement, be consolidated with any of the company's subsidiaries.

1.19 Unless we otherwise specify, we agree that the regulatory financial statements that Network Rail will provide us with should be based on a consolidation of Network Rail's company accounts with the accounts of Network Rail (CTRL) Limited, Network Rail Development Limited, Network Rail Insurance Limited, Network Rail (Spacia) Limited and Network Rail Infrastructure Finance PLC.

³ Before 1 April 2009, this period was 18 months.

Auditors

1.20 Network Rail is required to obtain from its auditors (under paragraphs 10 and 11 of Condition 11) reports on:

- the regulatory financial statements; and
- Network Rail's statement on the adequacy of its resources.

1.21 The form of these reports has been established following discussion between us and Network Rail, together with engagement letters that govern the responsibilities of the auditors and the duty of care owed to both Network Rail and us. Paragraphs 2.20 to 2.25 provide further explanation of the auditor's role.

Delivery and publication – process

1.22 Condition 11 requires that Network Rail deliver to ORR, the regulatory accounts (as set out in paragraph 1.12 above), as soon as reasonably practicable and in any event not later than 1 July following the end of the relevant financial year – or by a later date approved by us.

1.23 This information should be submitted in hard and soft (electronic) copy, with the regulatory financial statements contained in a spreadsheet showing clearly details of calculations undertaken by Network Rail, e.g. showing the formulas used in the calculations.

1.24 If there is a difference between the regulatory accounts that have been submitted by Network Rail and the requirements of these Guidelines we would consider whether or not to accept those regulatory accounts or require modifications to be made to the information submitted. Subject to any modifications, Network Rail must then publish the information within one calendar month of delivery to ORR.

Components of this document

1.25 The rest of this document covers the following areas:

- chapter 2 sets out a description of the content of the regulatory accounts (as set out in paragraph 1.12), a description of the requirements of the statement of adequacy of resources, a description of how the regulatory accounts will be externally verified, and guidance for the calculation of net debt for Network Rail's network licence condition 3: Level of financial indebtedness;
- chapter 3 sets out our policies relating to information required to be submitted in the regulatory accounts; and
- the annexes to these Guidelines contain further information on the contents of the regulatory accounts, how the regulatory accounts should be prepared, e.g. definitions and conditions 3 and 11 of Network Rail's network licence.

2. Components of the regulatory accounts

Introduction

2.1 This chapter sets out details of the financial and other information that Network Rail is required to provide in its regulatory accounts as set out in Condition 11.

Network licence conditions 3 “Level of financial indebtedness” and 11 “Regulatory accounts”

2.2 Following a review of Network Rail’s network licence in PR08⁴ some modifications to network licence conditions 3 and 11 were made on 1 April 2009.⁵ These modifications, apart from the changes to the requirements for the statement of adequacy of resources discussed below, mainly refer to how Network Rail prepares its regulatory accounts and what information ORR can require to be included in them.

2.3 We also changed Network Rail’s network licence condition 3: Level of financial indebtedness with effect from 1 April 2010. This change strengthened the condition by revising the limits to the level of financial indebtedness and making other related changes. Paragraphs 2.29 to 2.33 provide the guidance for the calculation of net debt for the purpose of network licence condition 3: Level of financial indebtedness.⁶

⁴ *Periodic review 2008: Determination of Network Rail’s outputs and funding for 2009-14*, Office of Rail Regulation, October 2008. This may be accessed at <http://www.rail-reg.gov.uk/upload/pdf/383.pdf>.

⁵ These conditions were renumbered on 1 April 2009. Before the licence was modified on 1 April 2009 these licence conditions used to be licence conditions 22 and 29. Our document on the review of Network Rail’s network licence contains more details. This may be accessed at <http://www.rail-reg.gov.uk/upload/pdf/394.pdf>.

⁶ Our document on the review of Network Rail’s level of financial indebtedness licence condition contains more details. This may be accessed at <http://www.rail-reg.gov.uk/upload/pdf/financial-indebtedness-notice-310310.pdf>.

Regulatory financial statements

- 2.4 Condition 11.2 requires Network Rail to prepare regulatory financial statements in relation to itself and also separately in relation to Network Rail Infrastructure Finance PLC ('NRIF')⁷ in accordance with Condition 11 and with these Guidelines.
- 2.5 In addition to the requirements of Condition 11⁸ Network Rail's regulatory accounts should comprise the items listed in annex A and the spreadsheet: RAGs – template regulatory financial statements 2011-12 for Network Rail and, if required by the ORR, for NRIF.
- 2.6 Annex A and the spreadsheet: RAGs – template regulatory financial statements 2011-12 contain details of the information for 2011-12 that will be published by Network Rail and covered by the audit opinion. Annex A and the spreadsheet: RAGs – template regulatory financial statements 2011-12 also contain details of the information that will only be provided to us and be subject to a review by the auditors or the reporter as appropriate for 2011-12. For the avoidance of doubt unless we say otherwise the information will be published in Network Rail's regulatory accounts and covered by the audit opinion.
- 2.7 From 2006-07, as well as the consolidated regulatory financial statements for Great Britain, the regulatory accounts also include segmented regulatory financial statements for England & Wales and Scotland. In CP4, this will be for each of the elements listed in annex A. The requirement and approach to producing these segmented statements is explained further in paragraphs 3.72 to 3.74 and in annex A and B.
- 2.8 From 2010-11, the regulatory accounts included disaggregated regulatory financial statements for each operating route.⁹ The requirement and approach

⁷ Network Rail Infrastructure Finance is the special purpose vehicle that Network Rail has established to facilitate the licence holder's long-term debt issuance programme. Condition 11.14 requires Network Rail to procure an undertaking from NRIF to enable Network Rail's obligations under Condition 11.2 to be performed.

⁸ For example, the statement of regulatory financial performance is required by Condition 11.4(c), to compare income and expenditure for the period with the assumptions underlying the most recent access charges review (the 'Determination Assumptions').

⁹ The operating routes are: Anglia, East Midland, Kent, London North Eastern, London North Western, Scotland, Sussex, Wales, Wessex and Western. Note that Network Rail

to producing these segmented statements is explained further in paragraphs 3.75 to 3.77 and in annex A and B.

- 2.9 From 2010-11, the regulatory accounts also included statements on Network Rail's efficiency, and information about its maintenance and renewals unit costs. Previously, this information was provided in Network Rail's annual return but following a review of the annual return we moved this information to Network Rail's regulatory accounts.
- 2.10 In addition, the following items should be included in the regulatory accounts:
- (a) a directors' review, including analysis of financial performance in the year and highlighting any material variances from the Determination Assumptions;
 - (b) a statement of the directors' responsibilities; and
 - (c) a statement of accounting policies.
- 2.11 Appropriate audited statutory financial statements procured by Network Rail from NRIF should also be provided to us as soon as reasonably practicable and in any event not later than 1 July following the end of the relevant financial year – or by a later date approved by us.
- 2.12 The templates, provided in the document "RAGs - template regulatory financial statements 2011-12", should be followed. Presentation of the required information may be adapted following our agreement, provided it is analysed, aggregated, presented and commented on in a form that readily conveys the same information.
- 2.13 The directors' review should include appropriate narrative, which should be included with the regulatory financial statements for each line item in the regulatory financial statements, explaining the material variances from the previous year and from Determination Assumptions, and explaining other features of the year under review and where appropriate the cumulative position which we or Network Rail considers are relevant to an appreciation of

created a separate operating route for Wales (from parts of Western and London North West operating routes) in 2011-12.

its regulatory financial performance, financial position and future prospects.¹⁰ By material in this context we mean any variance that is 10% lower/higher than our PR08 determination or the previous year as relevant and greater than £5m. The director's review will also report on Network Rail's compliance with the de-minimis limits set out in its network licence and in our consents.¹¹

Statement of adequacy of resources

2.14 The modifications to Network Rail's network licence discussed above that took effect from 1 April 2009 have changed Network Rail's obligations in relation to the statement of adequacy of resources with effect from that date. These obligations are contained in Condition 4.14 and include a requirement that the licence holder shall at all times act in a manner calculated to secure that it has available to itself sufficient resources, including (without limitation) management and financial resources, personnel, fixed and moveable assets, rights, licences, consents, and facilities to enable it to carry on the permitted business and comply with its obligations under the Railways Act 1993 (as amended) and its network licence. In addition, under the revised Condition 11, Network Rail is required to make a statement, approved by a resolution of its board of directors, certifying the adequacy of its resources for a period of time commencing on the date of the statement. The main changes to Network Rail's obligations are that:

- (a) the period of time to be covered is now 12 months instead of 18 months;
- (b) the definition of resources has been widened; and
- (c) the statement will include forward looking financial indicators that look at least three years ahead supported by robust projections that have been externally verified. The following table identifies the minimum forward looking financial indicators to be included.

¹⁰ This narrative should be sufficiently detailed so that the reasons for the differences in income and costs are explained. For example: if there is an increase in staff costs, it will be explained with reference to: the change in number of people employed, pay awards, the effect of leavers/joiners, the effect of promotions etc.

¹¹ This information does not need to be included within the directors' review if it is included elsewhere within the regulatory financial statements. The de-minimis limits are included in condition 4 of Network Rail's network licence. This may be accessed at http://www.rail-reg.gov.uk/upload/pdf/netwrk_licence.pdf.

Financial indicator	Definition
Adjusted interest cover ratio (AICR)	Funds from operations (FFO) ¹² less renewals and enhancement expenditure that will not be added to the RAB less capital expenditure to maintain the network in steady state divided by net interest ¹³
FFO/interest	FFO divided by net interest
Debt/RAB (gearing)	Net debt divided by RAB
FFO/debt	FFO divided by net debt
RCF ¹⁴ /debt	FFO less net interest divided by net debt

- 2.15 The financial ratios will be based on the forecasts included in Network Rail's latest update of its CP4 delivery plan as long as that plan was published no more than four months before the date that the regulatory accounts are published and there have been no changes to its forecasts that would materially affect the forward looking financial ratios. If the latest update of its CP4 delivery plan has been published more than four months before the date that the regulatory accounts are published then we will discuss with Network Rail what forecasts the financial ratios will be based on.
- 2.16 Network Rail will also provide a statement by the auditors confirming that in its view there are no changes to its forecasts that would have a material effect on the forward looking financial ratios.
- 2.17 This statement by the auditors will focus on the material issues that could affect Network Rail's forecasts. The revised form of this statement is prescribed in the revised Condition 11 (see annex C).

¹² FFO is the gross income less opex, less maintenance, less schedule 4 & 8 costs, less cash corporation taxes paid.

¹³ Net interest is the total interest cost including the FIM fee, but excluding the principal accretion on index linked debt.

¹⁴ Retained cash flow (RCF) is defined as FFO minus net interest.

- 2.18 The statement of adequacy of resources should be submitted along with the auditors' report on the statement of adequacy of resources at the same time as the regulatory accounts, i.e. as soon as reasonably practicable and in any event not later than 1 July following the end of the financial year to which they relate (or by a later date approved by us).
- 2.19 The purpose of the statement of adequacy of resources is to provide us and other interested parties with assurance on the future financial position of Network Rail.

Auditors' role

- 2.20 In common with Companies Act 2006 accounts, regulatory accounts are audited. The format for the audit of the regulatory accounts will be set out in a terms of engagement letter. This engagement letter forms part of the contract of appointment with the auditors, which Network Rail is required to obtain under Condition 11.12.
- 2.21 Condition 11.10 requires Network Rail to procure a report by the auditors addressed to ORR stating whether, in their opinion, the regulatory financial statements present fairly the financial performance and financial position of Network Rail and of NRIF (and any of NRIF's subsidiaries) and have been prepared in accordance with Condition 11 and these Guidelines. This audit opinion should identify material areas of judgement and any other material circumstances which appear to the auditors to be relevant having regard to these Guidelines and to the scope of work agreed with ORR.
- 2.22 Annex A and the spreadsheet: RAGs – template regulatory financial statements 2011-12 contain details of the information for 2011-12 that will be published by Network Rail and covered by the audit opinion. Annex A and the spreadsheet: RAGs – template regulatory financial statements 2011-12 also contain details of the information that will only be provided to us and be subject to a review by the auditors or the reporter as appropriate for 2011-12. For the avoidance of doubt unless we say otherwise the information will be published in Network Rail's regulatory accounts and covered by the audit opinion.
- 2.23 The audit report should also state whether the information on enhancement expenditure, produced in accordance with Condition 11.9(d), has been prepared in accordance with the Guidelines.

- 2.24 Condition 11.11 requires that each statement made by Network Rail under Condition 11.5 (the statement of the adequacy of resources) shall be accompanied by a report from the auditors stating whether or not they are aware of any inconsistencies between that statement and the regulatory financial statements or any information obtained by the auditors in the course of their audit work for Network Rail, and, if so, what these inconsistencies are.
- 2.25 The disaggregated regulatory financial statements of England & Wales and Scotland, and of each operating route will be covered by the audit opinion.

Use of a reporter

- 2.26 Where appropriate we will use a reporter¹⁵ to validate some of the information provided by Network Rail in the regulatory accounts. This will complement the work of the auditors.

Other statements/notes

- 2.27 A note should be included to show all details reasonably necessary to reconcile items included in the primary statements and the statement that analyses net debt with any similar items in the accounts prepared under the Companies Act 2006 for the same period. In particular, the note should enable:
- (a) comparison of opex in the regulatory accounts to opex in the accounts prepared under the Companies Act 2006;
 - (b) comparison of the movements in fixed assets on the company's balance sheet (prepared under the Companies Act 2006) over the year with movements in the value of the RAB over the corresponding year; and
 - (c) comparison of the movements in net debt in the company's balance sheet (prepared under the Companies Act 2006) over the year with movements in net debt in the regulatory accounts.
- 2.28 Any other statements and supporting notes as required to fairly present the financial performance and financial position of the licence holder in accordance with Condition 11 and these Guidelines should be provided.

¹⁵ The reporter for this work at the moment is Ove Arup.

Guidance for the calculation of net debt for Network Rail's network licence condition 3: Level of financial indebtedness

- 2.29 Network Rail's network licence condition 3: Level of financial indebtedness places limits on the levels of Network Rail's financial indebtedness. From 1 April 2010 the following guidance applies.
- 2.30 Unless we otherwise agree, with the exception of the requirements of Network Rail's network licence condition 3: Level of financial indebtedness, the measurement of the liabilities, assets or investments for the purpose of that condition will be in accordance with the measurement of the liabilities, assets or investments for the purposes of Network Rail's Companies Act 2006 accounts.
- 2.31 For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of change in value.
- 2.32 Licence condition 3: Level of financial indebtedness uses a purposive type of definition of financial indebtedness. It is also useful to clarify what we mean by financial indebtedness by providing some specific examples of financial instruments that would be included in the definition. These examples are set out in the following paragraph.
- 2.33 Financial instruments that would be included as financial indebtedness include:
- (a) moneys borrowed;
 - (b) any acceptance credit;
 - (c) any bond, note, debenture, loan stock or other similar instrument;
 - (d) collateral;
 - (e) working capital facilities;
 - (f) gilt locks;
 - (g) any redeemable preference share;
 - (h) any finance or capital lease;

- (i) any foreign currency derivative transaction protecting against or benefiting from fluctuations in foreign exchange rates;
- (j) any counter-indemnity obligation in respect of any guarantee, indemnity, bond, letter of credit or any other instrument issued by a bank or financial institution; and
- (k) any guarantee, indemnity or similar assurance against financial loss of any person in respect of any item referred to in paragraphs (a) to (i) above.

3. Policies

Introduction

- 3.1 A key objective of these Guidelines is to establish regulatory accounts that are fully consistent with the regulatory framework established by our PR08 determination. The key elements of this regulatory framework that are relevant to the regulatory accounts, and resulting regulatory accounting policies, are set out in this chapter.

Background

- 3.2 Our PR08 determination established the regulatory framework under which Network Rail would operate for the five years between April 2009 and March 2014, including the revenue requirement, the financial framework and the incentive framework.
- 3.3 In assessing Network Rail's revenue requirement, we adopted the standard 'building block' methodology used by other economic regulators and the Competition Commission. Under this approach, the total amount of money that Network Rail receives in income is calculated as the sum of forecast expenditure on operating and maintaining the network, plus an allowance for amortisation of the RAB and an overall return on the RAB, less other income received through the single till arrangements.

Indexation

- 3.4 Appropriate indexation should be applied to all figures carried forward from previous years to ensure that all figures are presented in a consistent price base. Indexation adjustments should be calculated with reference to the Retail Price Index ('the RPI') published by the Office of National Statistics ('the ONS') and based on the index RPI CHAW, available from the ONS website.¹⁶
- 3.5 Using the RPI CHAW index to convert to 2011-12 prices,¹⁷ indexation of 1.05159 should be applied to all figures expressed in 2010-11 prices,

¹⁶ For further information see:
<http://www.statistics.gov.uk/STATBASE/tsdataset.asp?vlnk=229&More=Y>.

¹⁷ The movement in the RPI CHAW index from November to November.

indexation of 1.10111 should be applied to all figures expressed in 2009-10 prices, indexation of 1.10417 should be applied to all figures expressed in 2008-09 prices, indexation of 1.13734 should be applied to all figures expressed in 2007-08 prices and indexation of 1.18598 should be applied to all figures expressed in 2006-07 prices. During CP4, the indexation adjustments will be updated to reflect movements in the RPI CHAW index.

Amortisation allowances

- 3.6 Our PR08 determination remunerated capital expenditure through an allowance for amortisation, based on average annual long-run steady state capital expenditure,¹⁸ except for CP3 non-capital expenditure additions, which are amortised over 30 years.¹⁹ Under this approach renewals and enhancement expenditure (less Ring-fenced fund (RFF) funded expenditure) are added to the RAB and there is a reduction in the value of the RAB to reflect amortisation (or depreciation) of the assets over time. A corresponding amortisation payment is received by Network Rail as part of its revenue requirement to remunerate it for the expenditure. A more detailed discussion of our PR08 amortisation rules is contained within our PR08 determination document (see paragraphs 15.78 to 15.82 of chapter 15).²⁰
- 3.7 The outstanding amount of the CP3 non-capex RAB additions will be reported in the regulatory accounts as a memo item. See annex A, statement 2b: *RAB - Reconciliation of expenditure*.
- 3.8 Although we have not changed the principle for calculating amortisation from that used in CP3, we have simplified the rules for adjusting the RAB so that we no longer distinguish between the RAB at 1 April 2004 and investment expenditure incurred after 31 March 2004. This has no effect on the value of the RAB or the revenue that Network Rail receives.

¹⁸ See paragraph 15.79 of our PR08 determination. We also need to consider financial sustainability issues as set out in *Approach to the amortisation of Network Rail's regulatory asset base*, Office of Rail Regulation, September 2006. This may be accessed at www.rail-reg.gov.uk/upload/pdf/pr08-amortisation-let-290906.pdf.

¹⁹ See paragraph 15.81 of our PR08 determination.

²⁰ Periodic review 2008: *Determination of Network Rail's outputs and funding for 2009-14*, Office of Rail Regulation, October 2008. This may be accessed at www.rail-reg.gov.uk/upload/pdf/383.pdf.

Amortisation of investment framework investments

- 3.9 Amortisation will also be deducted from certain categories of non-PR08 enhancement expenditure that will be added to the RAB through the investment framework. As a basic principle, amortisation will be deducted from non-PR08 enhancement schemes where Network Rail is being reimbursed for the capital cost of the expenditure through a charge (or is deemed to receive an economic benefit equivalent to the amortisation charge). The amortisation charge to be deducted from the RAB should be equal to the income that Network Rail receives as a reimbursement for the capital cost of the expenditure (or deemed economic equivalent).

Ring-fenced fund

- 3.10 Chapter 14 of our PR08 determination contains a description of the methodology we have used for calculating the ring-fenced fund (RFF) and how it will work. Given that the RFF funds a proportion of the renewals and enhancements that is required to deliver the high level output specifications ('HLOSs') on a pay-as-you-go basis, it is necessary to make a deduction from the RAB equal to the amount of renewals and enhancements that the RFF funded as part of PR08 to ensure that Network Rail does not get paid twice.²¹
- 3.11 For the purpose of rolling forward the RAB, renewals and enhancements will be assessed gross of the RFF. The RFF will not be affected by the RAB roll forward policy.
- 3.12 The RFF would be reduced in size if Network Rail needed to defer capex. The process Network Rail needs to follow to defer capex is described in Chapter 14 of our PR08 determination.

RAB roll forward

Background

- 3.13 A key purpose of the regulatory accounts is to monitor and roll forward the RAB and monitor capex. This section of the document provides further explanation of how we will roll forward the RAB.

²¹ It is clearer for Network Rail's regulatory accounts to show total renewals and enhancements including those funded by the RFF together with an adjustment that deducts the amount of renewals and enhancements funded by the RFF instead of showing net renewals and enhancements.

- 3.14 In CP4, the closing RAB for each year is calculated as the opening RAB plus an inflation adjustment plus renewals and enhancements expenditure (after adjusting for the effect of the RAB roll forward policy as described below) less the amount of renewals and enhancements funded through the RFF less amortisation.
- 3.15 This methodology differs from that adopted in our access charges review 2003 in two main ways. Firstly, actual expenditure will be added to the RAB (after adjusting for the effect of the RAB roll forward policy as described below) instead of the determination assumption being added to the RAB. Secondly, there is a deduction for RFF funding. These changes are explained in detail in Chapter 15 of our PR08 determination.²² Under our PR08 approach, generally, deviations from the expenditure allowance are retained/borne by the company as out/under-performance for a period of 5 years, provided Network Rail has delivered the required outputs. This general approach is used widely in other regulated industries and represents a key feature of the incentive framework established by our PR08 determination.
- 3.16 Our PR08 determination established an allowance for renewals and enhancement expenditure in CP4 that would enable Network Rail to deliver the required outputs in CP4 and to sustain the long term condition of the network (i.e. the network should not experience any adverse impacts on the serviceability or sustainability of the network in the short, medium or long term). Generally, in this section of the Guidelines when we refer to a non-delivery of outputs we also mean a failure to maintain the serviceability or sustainability of the network at an appropriate level.
- 3.17 Details of the outputs Network Rail needs to deliver in CP4 are included in our PR08 determination and Network Rail's latest delivery plan update.
- 3.18 Chapter 15 of our PR08 determination sets out at a high level how we will roll forward the RAB in CP4. The main features of the RAB roll forward policy are described below.
- 3.19 The main features of our RAB roll forward policy are:

²² Periodic review 2008: *Determination of Network Rail's outputs and funding for 2009-14*, Office of Rail Regulation, October 2008. This may be accessed at www.rail-reg.gov.uk/upload/pdf/383.pdf.

- (a) to provide an appropriate balance of incentives and protections for Network Rail by adding actual efficient capex to the RAB in CP4 (subject to the RAB roll forward policy). This means that Network Rail is protected from some risks but will suffer from some underperformance and will benefit from outperformance;
- (b) the incentives the company faces are equalised across the five years of the control period, for example, Network Rail faces the same incentive to outperform in the last year of CP4 as it does in the first year of CP4 and will bear the same cost of efficient overspend in year 5 of CP4 as in year 1 of CP4;
- (c) in order to simplify the calculations of the financial effect of a five year retention in our PR08 determination we set the incentive rate at 25%, which is approximately the same as five years allowed return at 4.75%. This is also called the 25% pain/gain sharing mechanism.²³ Also, in order to simplify the calculation we make the relevant RAB additions/deductions in the year when they occur;
- (d) if an efficient overspend is added to the RAB, Network Rail will bear 25% of the overspend. If the overspend is not eligible for a RAB addition or is not offset against an efficient underspend, Network Rail will lose 100% of the overspend;
- (e) Network Rail will retain 25% of an efficient underspend (irrespective of whether the underspend is due to a variance in volumes or unit costs);
- (f) Network Rail will not be penalised for or benefit from rescheduling (deferring work or bringing work forward) its capex programme within CP4 where outputs are met. By not penalising or rewarding Network Rail we mean that we will not treat the expenditure variance as an efficiency or inefficiency (subject to Network Rail showing that the required outputs in CP4 have been delivered and there is no adverse effect on the serviceability and sustainability of the network in the short, medium or long term). This means that we will adjust the RAB for the financial effect of rescheduling activity, so that Network Rail does not

²³ This is calculated as the amount of underspend/overspend plus associated capitalised financing from the year in which the underspend/overspend occurred, less 25% of the underspend (with no capitalised financing accruing on the 25% adjustment).

retain/bear the financing benefit/cost of the rescheduling, i.e. if there is a deferral of work from year 1 to year 2, in our PR08 determination Network Rail will have received an allowed return on that work for year 1. In order to make the effect of rescheduling within CP4 neutral, we will deduct from the RAB the amount of financing that Network Rail received for that work for the period until the work is done in year 2. For the avoidance of doubt, these adjustments will not be subject to the 25% pain/gain sharing mechanism; and

- (g) we will log down the RAB for non-delivery of outputs²⁴ regardless of whether there is an underspend or overspend. We will also make an adjustment for capitalised financing on the logged down amount and Network Rail will not retain 25% of an underspend.

General policy issues

3.20 Before we set out the specific issues that apply to renewals and enhancements, the following general policy issues apply to both renewals and enhancements:

- (a) renewals and enhancements will be rolled forward separately for England & Wales and Scotland in accordance with our PR08 determination;
- (b) all RAB adjustments for the non-delivery of outputs, deferrals within CP4, underspend and efficient overspend, will be calculated with reference to our PR08 determination;²⁵

²⁴ Adjustments for non delivery of outputs include adjustments for Network Rail failing to maintain the serviceability or sustainability of the network in the short, medium or long term.

²⁵ Network Rail has restated its asset policies and they are different to the asset policies used in deriving the PR08 determination. We have reviewed these revised asset policies and with the exception of the civils asset policy, which is still being reviewed, they will provide the basis for examining volume and unit costs issues for the 2010-11 RAB roll forward. For renewals, the difference between the expenditure calculated by multiplying the volumes and related unit costs together and the total allowance in the determination will be treated as unit cost related expenditure (i.e. expenditure that does not have a supporting volume attached to it) unless Network Rail can show that the issue is volume related. The delivery plan and its updates have no effect in total on our treatment of enhancements.

- (c) the adjustments for the non-delivery of outputs will be based on the amounts of money saved by not delivering the outputs or failing to maintain the serviceability and sustainability of the network. This would include any savings in opex, maintenance and income;
- (d) it is for Network Rail to show that a reduction in work volumes is efficient and does not inappropriately affect the serviceability and sustainability of the network. Where Network Rail cannot show that a reduction in volumes is efficient, any cost savings related to the deviation from the current agreed asset policies will be deemed inefficient and the related cost savings will be deducted from the RAB without Network Rail retaining 25% of the benefit;
- (e) additional volumes of work will only be considered for addition to the RAB if they lead to an overspend. Additional volumes associated with an underspend will not be added to the RAB;
- (f) the assessment of the RAB is a cumulative assessment for CP4, i.e. an overspend in year 1 would be offset by underspend in year 2. This means that it will only be possible to finalise the value of the RAB once CP4 is completed. All annual calculations of the RAB during CP4 in the regulatory accounts will therefore be provisional; and
- (g) agreed deferrals of expenditure from CP3 to CP4 (e.g. West Coast) will be treated under the CP4 RAB roll forward policy (e.g. if Network Rail delivers these outputs and spends below the determination assumption then Network Rail will retain 25% of the underspend), unless agreed otherwise.

General process issues

3.21 The following general process issues apply to both renewals and enhancements:

- (a) Network Rail will include in its regulatory accounts its estimate of the RAB annually and we will assess its estimate and report on it in our annual assessment of Network Rail. It is hoped that the estimates of the RAB will be as accurate as possible. However, the estimates will be provisional until an ex-post assessment at the beginning of the next control period has been completed i.e. the closing CP4 RAB will remain

provisional until after the end of CP4, and will only be finalised after the end of CP4;

- (b) capex should be recorded and added to the RAB in three broad categories: renewals, enhancements funded by our PR08 determination, and enhancements not funded by our PR08 determination but approved by us ('non-PR08 enhancements');
- (c) in order for any expenditure greater than the determination to be considered for a RAB addition under the RAB roll forward policy, Network Rail will need to provide full and comprehensive supporting documentation that clearly identifies all the relevant issues and shows that the proposed capex to be added to the RAB qualifies under the criteria set out in our PR08 determination. The burden of proof is on Network Rail to show that a RAB addition is justified, not us. Network Rail needs to submit this information to us one month after the end of Network Rail's financial year at the latest. Network Rail will not be able to resubmit inappropriate submissions, unless agreed otherwise by us. If Network Rail is not able to show that our PR08 determination criteria have been met and provide the appropriate documentation in time, or if the submission is inadequate, the expenditure will not be added to the RAB; and
- (d) material errors in the regulatory accounts need to be corrected by restating the regulatory accounts that contain the incorrect information unless we agree otherwise. We will specify how other errors will be treated at the time that we become aware of the error.

Renewals

General

- 3.22 The policy and process for adding renewals to the RAB is the same in England & Wales as for Scotland.
- 3.23 The Infrastructure Output Price Index (IOPI)²⁶ input price adjustment²⁷ is applied in each year to PR08 renewals after adjusting for the agreed changes

²⁶ The index is available from the Building Cost Information Service, which is part of the Royal Institute of Chartered Surveyors.

to our PR08 determination and after adjusting for deferrals and non-delivery of outputs.

- 3.24 The following table contains the numbers for our PR08 determination renewals input price and frontier shift assumptions that will be used by Network Rail when making the IOPI input price adjustment.

Table 1: PR08 determination renewals input price and frontier shift assumptions

Year	Input price assumption (%)	Frontier shift assumption (%)
2009-10	0.9	0.7
2010-11	1.4	0.7
2011-12	0.8	0.7
2012-13	0.1	0.7
2013-14	0.2	0.7

- 3.25 The following paragraph contains a worked example of how the IOPI input price adjustment would work.
- 3.26 If the IOPI index moves by +10% in year 1 of CP4 and RPI moves by 0.28% then the renewals price adjustment will be: $10\% - (0.28\% + 0.9\% - 0.7\%) = 9.52\%$. As 9.52% is higher than 1.9% (0.9% + 1%), Network Rail would make an adjustment to the RAB of $9.52\% - 1\% = 8.52\%$.
- 3.27 The base year for the IOPI input price adjustment is 2008-09 and the adjustment will be based on the movement in the index from Q4 to Q4 of the calendar year (which is a similar time period as the RPI adjustment to revenue).²⁸ The Q4 index is provisionally available in March, is updated in

²⁷ Logging up or down will be made on an annual basis using the following calculation: Renewals price adjustment = IOPI – (RPI + our PR08 input price assumption – our frontier shift assumption) +/-1%. We will only log up or log down to the RAB if the renewals price adjustment is greater or lesser than the input price assumption in our determination by 1%. If it is greater or lesser than 1%, then the renewals price adjustment is reduced/increased by 1%. See paragraphs 15.55 and 15.56 in our PR08 determination for further information.

²⁸ The movement from Q4 to Q4 is equal to the movement from December to December and therefore similar to the movement from November to November, which is used to adjust revenue for RPI as described in paragraph 3.5.

June and is finalised in September. Network Rail should use the updated provisional number produced in June for the purpose of making the IOPI adjustment. The difference between the final number and the June provisional number will be adjusted for in the following year.²⁹ The annual adjustment for the IOPI index will be calculated on a cumulative basis (i.e. the base year remains 2008-09 for each year of CP4).

- 3.28 Under/over spends on renewals that have no associated volumes e.g. information management, will be treated as unit cost related under/over spends.
- 3.29 As the roll forward of Network Rail's RAB in CP4 is cumulative, it will be important that Network Rail keeps a record of the net under/over spends for volumes and unit costs in every year of CP4 even where there is not an aggregate overspend as an aggregate overspend may occur in later years of CP4 as shown in statement 2b: *RAB – reconciliation of expenditure*.

Process for calculating whether there is a renewals under/over spend

- 3.30 The process for determining whether Network Rail is underspending or overspending its renewals allowance is firstly to calculate the baseline determination by:
- (a) uplifting the renewals assumption in the determination to the price base in the relevant year as described in paragraphs 3.4 to 3.5;
 - (b) adjusting the determination for the agreed changes to it as discussed in paragraph 3.50;³⁰
 - (c) deducting the effect of any non-delivery of outputs or a failure to maintain the network's serviceability and sustainability at an appropriate level; and
 - (d) adjusting for any deferral of expenditure.

Then, apply the IOPI adjustment to the balance after step (d) to determine the baseline determination.

²⁹ For the purposes of the financial ratios required for the statement of adequacy of resources, Network Rail will need to use a forecast IOPI.

³⁰ The change control process is explained in the PR08 determination.

The baseline determination is then deducted from actual expenditure to determine whether there is an underspend or overspend. If there is an underspend it will be deemed efficient as long as Network Rail can show that the underspend has not inappropriately affected the serviceability and sustainability of the network as described earlier, if there is an overspend it will be deemed inefficient, unless Network Rail can demonstrate that it is efficient in the way outlined in paragraph 3.32.³¹

Renewals underspend

3.31 Network Rail will retain 25% of an efficient underspend. Where an underspend is inefficient, i.e. Network Rail has not delivered the required outputs or Network Rail has adversely affected the serviceability and sustainability of the network, Network Rail will not benefit from the underspend because we will reduce the RAB for the expenditure included in the determination and any financing benefit received by Network Rail. Failure to deliver outputs may also result in us taking enforcement action in accordance with our policy.

Renewals overspend

3.32 The efficiency of an overspend on renewals will be assessed ex-post. No overspend on renewals unit costs will be added to the RAB (apart from, where relevant, an IOPI adjustment). This is because unit costs are controllable by Network Rail and the company is provided with protections for unit cost risks elsewhere in the determination. An overspend on volumes will only be allowed to be added to the RAB if:

- (a) the expenditure is efficiently incurred; and
- (b) the expenditure could not have reasonably been foreseen at the time of our PR08 determination.

For example, Network Rail would need to show that the increase in volumes related to:

- (a) improvements in asset policies that demonstrate optimisation of whole life costs. Network Rail would need to set out its starting volume

³¹ i.e. the burden of proof is on Network Rail.

assumption based on our PR08 determination and then set out and justify the incremental volume;

- (b) systemic issues with asset condition that could not reasonably have been foreseen at the time of our PR08 determination. This makes the strong assumption that Network Rail's asset information is compliant with its network licence;
- (c) unanticipated increases in traffic volume on a particular part of the network resulting in the need for increased renewals, in line with asset policies. Network Rail would need to demonstrate that the associated costs were greater than any additional revenues received in track access charges and payments under the volume incentive;
- (d) work brought forward in order to minimise total cost. For example, we would generally expect to allow for the bringing forward of work based on a material change to policy concerning the way in which work is packaged where Network Rail can demonstrate whole life cost effectiveness. We would need to be convinced that the packaging of work and the bringing forward of the work (rather than deferring) was justified; or
- (e) external factors that could not have reasonably been taken into account at our PR08 determination.

Where the design specification and asset management policies should mean that failure should not have occurred, we would not expect to allow the costs of renewal to be logged up. Any insurance payments received would be netted off allowed capex costs.

3.33 In an overspend situation our policy treats variances on volumes and unit costs differently. In practice, Network Rail is unlikely to underspend on everything it does or overspend on everything it does. Therefore, in some situations we will look at the aggregate position as summarised below:

- (a) output variances will not be aggregated, i.e. we will look at all output variances individually and not combine them with another variance whether output related or not - e.g. if there is a non-delivery of an output it cannot be compensated for by a better than expected output elsewhere or by an underspend in signalling volumes or unit costs;

- (b) unit cost variances will be aggregated, i.e. we will look at all unit cost variances together but not combine them with another variance - e.g. an overspend in track unit costs can be offset by an underspend in signalling unit costs but not by an underspend in signalling volumes or better than expected outputs; and
- (c) volume variances will be aggregated within each of the following categories:
 - (i) deferrals and advancement of volume variances will be aggregated, i.e. we will look at all deferral and advancement of volume variances together but not combine them with another variance - e.g. signalling volumes being brought forward from later in CP4 can be offset by a deferral of volumes in electrification but not by lower signalling volumes due to efficiency or better than expected unit costs or outputs; and
 - (ii) volume variances either below/above the determination that are not deferrals or advancements agreed with us will be aggregated, i.e. we will look at all volume variances that are not due to a deferral or advancement together but not combine them with another variance - e.g. higher signalling volumes due to inefficiency can be offset by lower structures volumes due to efficiency but not by a deferral of volumes in electrification or better than expected unit costs or outputs.

3.34 In the case of an aggregate renewals overspend, Network Rail will need to set out the total net volume related variance and the total net unit cost related variance from the determination. No unit cost overspends will be added to the RAB. Only the net volume related overspend can be logged up to the RAB, if the relevant criteria have been met. This will require Network Rail to identify all the volume related variances from our PR08 determination in order to identify if the relevant criteria have been met, including volume underspend.

3.35 When working out the aggregate effect, in the situation where there is inefficient overspend and other types of under/over spend, firstly the inefficient overspend will be offset against efficient underspend. Any remaining inefficient overspend will not be added to the RAB.

Enhancements

General

3.36 Some of our policies for adding enhancement expenditure to the RAB are different for England & Wales and Scotland in accordance with our PR08 determination.

Process for calculating whether there is an enhancement under/over spend – in relation to the delivery of PR08 outputs

3.37 The process for determining whether Network Rail is underspending or overspending its enhancement allowance is firstly to calculate the baseline determination by:

- (a) uplifting the enhancement assumption in the determination to the price base in the relevant year as described in paragraphs 3.4 to 3.5;
- (b) adjusting the determination for the agreed changes to it as discussed in paragraph 3.52;³²
- (c) deducting the effect of any non-delivery of outputs or failure to maintain the serviceability or sustainability of the network at an appropriate level; and
- (d) adjusting for any deferral of expenditure.

The baseline determination is then deducted from actual expenditure to determine whether there is an underspend or overspend. If there is an underspend it will be deemed efficient as long as the required outputs are delivered in full. If there is an overspend it will be deemed inefficient, unless it is manifestly inefficient. Network Rail would have to justify the overspend and identify any manifestly inefficient spend. This process is the same for England & Wales as Scotland except that there is not a manifestly inefficient test in Scotland; instead there is an ex-post efficiency assessment.

3.38 Where we have provided funding to Network Rail that is not explicitly linked to specific outputs, i.e. 'funds' (e.g. the Network Rail discretionary fund, National Stations Improvements Programme (NSIP), Strategic Freight Network, the

³² The change control process is explained in paragraphs 4.69 to 4.75 of the PR08 determination.

small schemes fund in Scotland, Access for all, the CP5 development fund and the Safety & Environment fund in England & Wales and the small schemes/projects fund and the Tier 3 project fund in Scotland), we will deduct any underspend (including associated capitalised financing), irrespective of whether there is an aggregate capex overspend or underspend and Network Rail will not retain 25% of the underspend. No RAB additions will be made for any overspend on these funds or any associated capitalised financing.

- 3.39 For enhancements included in the determination and subject to a tailored protocol (i.e. Thameslink) or to a fixed price agreement (i.e. Airdrie - Bathgate), overspend and underspend will be treated as stated in the relevant protocol or fixed price agreement.

Enhancements underspend – in relation to the delivery of PR08 outputs

- 3.40 Network Rail will retain 25% of an efficient underspend. Where an underspend is inefficient - i.e. it has not delivered the required outputs - Network Rail will not benefit from the underspend, so we will reduce the RAB for the expenditure included in the determination and any financing benefit received by Network Rail. Failure to deliver outputs may also result in us taking enforcement action in accordance with our policy. The policy and process for treating an underspend on enhancements is the same in England & Wales as for Scotland.

Enhancements overspend – in relation to the delivery of PR08 outputs

- 3.41 In logging up capex overspend, we will differentiate between overspend associated with additional outputs, Network Rail self-financing investments and the delivery of outputs required under our PR08 regulatory determination.
- 3.42 Where a government requests Network Rail to deliver additional outputs during the control period, we will log up the efficient cost (including capitalised financing costs) of delivering the outputs for inclusion in the RAB at the beginning of the next control period. This is the same as the current approach. Our treatment of self-financing investments is described below.
- 3.43 In an enhancement overspend situation our policy treats variances on volumes and unit costs in the same way. In practice, Network Rail is unlikely to underspend on everything it does or overspend on everything it does.

Therefore, in some situations we will look at the aggregate position as summarised below:

- (a) output variances will not be aggregated, i.e. we will look at all output variances individually and not combine them with another variance whether output related or not - e.g. if there is a non-delivery of an output it cannot be compensated for by a better than expected output elsewhere or by an underspend in another enhancement scheme;
- (b) under/over spends whether volume or unit cost related but not related to a deferral or an advancement will be aggregated, i.e. we will look at all under/over spends as a result of volume or unit cost variances together but not combine them with another variance - e.g. an overspend due to higher unit costs in one scheme can be offset by a unit cost underspend in another scheme but not by better than expected outputs from a scheme or a deferral of another scheme; and
- (c) deferrals and advancements will be aggregated, i.e. we will look at all variances as a result of deferral and advancement of work on the schemes together but not combine them with another variance - e.g. expenditure on a scheme being brought forward from later in CP4 can be offset by a deferral of expenditure on another scheme but not by an underspend on a scheme as a result of volume or unit cost variances or by better than expected outputs from a scheme.

Enhancements overspend in England & Wales – in relation to the delivery of PR08 outputs

3.44 For enhancements included in the determination and not subject to a tailored protocol and not covered by specific funds (e.g. King's Cross and Reading):

- (a) Network Rail is not protected for the first £50m p.a. of any enhancement overspend. This is a cumulative threshold (i.e. the first £250m of overspend on enhancements in CP4 will not be added to the RAB). This means that the effect on Network Rail of a £50m p.a. overspend on enhancements in each year of a five year control period is the same as, for example:

- (i) the situation where there is an overspend in one year of £250m and in the other four years actual spend is equal to the determination; and
 - (ii) the situation where there is an overspend in one year of £350m and an underspend in one year of £100m and in the other three years actual spend is equal to the determination;
- (b) where overspend exceeds the £50m p.a. threshold, Network Rail will have to provide an explanation to us as to why the additional investment is justified. We would expect a key element of Network Rail's justification to be evidence that internal project management and investment authorisation controls had been properly applied. The burden of proof rests with Network Rail;
- (c) all justified overspend above the first £50m p.a. would be added to the RAB, with Network Rail bearing 25% of the overspend, unless the overspend is manifestly inefficient when the overspend will not be added to the RAB and Network Rail will bear 100% of the overspend;
- (d) if there is an overspend in PR08 enhancements that are not subject to a tailored protocol or are a fund, no manifestly inefficient expenditure will be added to the RAB (up to the total of the "baseline determination" overspend). This means that Network Rail will need to review the enhancement spend in England & Wales (excluding spend on tailored protocols or funds) annually and identify in a letter to us any manifestly inefficient spend. This needs to be done annually for each year of CP4, even where there is not an aggregate overspend as an aggregate overspend may occur in the later years of CP4; and
- (e) where we deem the overspend to be manifestly inefficient, there will be no RAB addition, with examples of manifestly inefficient being:
 - (i) the overspend is outside the scope of the HLOSs;
 - (ii) the overspend does not meet a customer reasonable requirement;
 - (iii) the overspend is not related to railway activities; and
 - (iv) the overspend does not add economic value to the railway.

Enhancements overspend in Scotland – in relation to the delivery of PR08 outputs

- 3.45 For enhancements included in the determination and not subject to a tailored protocol and not covered by specific funds (i.e. Glasgow Airport Rail Link, Borders, Glasgow to Kilmarnock and GSM-R on freight only lines) then Network Rail will have to justify the overspend. The burden of proof rests with Network Rail. We will then complete an ex-post efficiency assessment.
- 3.46 The efficiency assessment will be based on the same principles as the renewals volume assessment as described in paragraph 3.32.³³ If the overspend is deemed efficient, Network Rail bears 25% of the cost of the overspend. If the overspend is not deemed to be efficient, the overspend will not be added to the RAB and Network Rail will bear 100% of the overspend.

Calculation of the RAB

- 3.47 Statement 2a: *RAB (Regulatory financial position)* of the regulatory financial statements provides details of the roll forward of the RAB from year to year.
- 3.48 In summary, the process for rolling forward the RAB is:
- (a) uplift the CP4 opening RAB per our PR08 determination into 2008-09 prices and then uplift into the price base of the relevant year;
 - (b) adjust the value of the CP4 opening RAB per our PR08 determination for agreed changes as set out in our letter³⁴ that determined the final value of the CP4 opening RAB;
 - (c) adjust the RAB for any other agreed adjustments to the determination (e.g. seven day railway funding in renewals);
 - (d) add the renewals and enhancements RAB additions;
 - (e) deduct the element of renewals and enhancements that are funded by the RFF; and
 - (f) deduct our PR08 amortisation assumption.

³³ The renewals assessment is the same for England & Wales and Scotland.

³⁴ This may be accessed at <http://www.rail-reg.gov.uk/upload/pdf/actual-cp4-opening-rab-181209.pdf>.

3.49 Statement 2b: *RAB – reconciliation of expenditure* of the regulatory financial statements reconciles the renewals and enhancement allowance in our PR08 determination with the renewals and enhancements added to the RAB and actual renewals expenditure per statement 9a and 9b: *Analysis of renewals expenditure* and actual enhancement expenditure per statement 3: *Analysis of enhancement expenditure* of the regulatory financial statements.

Renewals reconciliations

3.50 The process for reconciling renewals expenditure is:

- (a) firstly, the renewals allowance in our PR08 determination is recorded:
- (b) secondly, any changes to the renewals allowance in our PR08 determination that have been agreed by us are recorded. This includes:
 - (i) adjustments for expenditure on the seven day railway;
 - (ii) changes to the allocation of renewals and enhancement expenditure in the delivery plan, agreed by us;
 - (iii) deferrals of expenditure from CP3 to CP4; and
 - (iv) any other adjustments agreed by us.
- (c) thirdly, all adjustments to the renewals expenditure per the RAB roll forward policy are recorded. This includes:
 - (i) adjustments for the non-delivery of outputs;
 - (ii) deferrals within CP4;
 - (iii) the IOPI index adjustment; and
 - (iv) adjustments for efficient and inefficient under/over spend, including where appropriate the 25% retention of any efficient under/over spend.

The total after step (c) is the renewals RAB addition per statement 2a: *RAB (Regulatory financial position)* of the regulatory financial statements.

3.51 In order to derive actual renewals spend we then adjust the renewals RAB addition for:

- (a) any overspend that was deemed inefficient and does not qualify for addition to the RAB;
- (b) remove any capitalised financing adjustments included in the RAB addition for renewals;
- (c) remove the adjustment for the 25% retention of over/underspend included in the RAB addition for renewals; and
- (d) any other necessary adjustment (including an explanation of the adjustment).

The total after step (d) is actual renewals expenditure per statement 9a and 9b: *Analysis of renewals expenditure*.

Enhancements reconciliations

3.52 The process for reconciling enhancements expenditure is:

- (a) firstly, the enhancements allowance in our PR08 determination is recorded:
- (b) secondly, any changes to the enhancements allowance in our PR08 determination that have been agreed by us are recorded. This includes:
 - (i) changes to the allocation of renewals and enhancement expenditure in the delivery plan, agreed by us;
 - (ii) deferrals of expenditure from CP3 to CP4;
 - (iii) deferrals of expenditure from CP4 to CP5 and any other changes to the delivery plan that have gone through change control; and
 - (iv) any other adjustments agreed by us.
- (c) thirdly, all adjustments to the enhancements expenditure per the RAB roll forward policy are recorded. This includes:
 - (i) adjustments for the non-delivery of outputs;

- (ii) deferrals within CP4; and
 - (iii) adjustments for efficient and inefficient under/over spend, including where appropriate the 25% retention of any efficient under/over spend and any adjustments for manifestly inefficient spend and Network Rail's retention of the first £50m p.a. of overspend.
- (d) Then, add all non-PR08 enhancements including the related capitalised financing and amortisation.³⁵

The total after step (d) is the enhancements RAB addition per statement 2a: *RAB (Regulatory financial position)* of the regulatory financial statements.

3.53 In order to derive actual enhancement spend we then adjust the enhancement RAB addition for:

- (a) any overspend that was deemed inefficient and does not qualify for addition to the RAB;
- (b) remove any capitalised financing adjustments included in the RAB addition for enhancements;
- (c) where appropriate, remove the adjustment for the 25% retention of over/under spend included in the RAB addition for enhancements; and
- (d) any other necessary adjustment (including an explanation of the adjustment).

3.54 The total after step (d) is actual enhancement expenditure per statement 3: *Analysis of enhancement capital expenditure* of the regulatory financial statements.

Other issues

3.55 In line with good regulatory practice, only capex will be added to the RAB from the start of CP4. Incentive payments, which in CP3 we added to the RAB, will instead be remunerated via an operating expenditure (opex) style memorandum account. This works by adding the payment to the opex

³⁵ For the avoidance of doubt, non-PR08 enhancements will not be subject to the 25% pain/gain mechanism.

memorandum account during the control period. Monies can then be released from the opex memorandum account over an appropriate period of time. The opex memorandum account is reported on in statement 12: *Other information* of the regulatory financial statements.

- 3.56 If there is an underspend on the NSIP, in relation to expenditure that is not enhancement expenditure - e.g. maintenance expenditure - an adjustment will be made through the opex memorandum account to ensure that Network Rail will not receive the benefit of this underspend (including any capitalised financing).

Capitalised financing

- 3.57 Capitalisation of financing costs in the period 2009-10 to 2013-14 should only be applied to certain items of expenditure incurred by Network Rail that were not funded by PR08. The only categories of expenditure recorded in the regulatory accounts that may in certain circumstances include an allowance for capitalised finance are therefore:

- (a) the difference between the actual CP4 opening RAB and the opening RAB assumed in our PR08 determination;
- (b) adjustments for changes to our PR08 determination, agreed by us;
- (c) adjustments for the non-delivery of outputs;
- (d) the adjustment for deferrals or the bringing forward of expenditure within CP4;
- (e) IOPI index adjustments;
- (f) addition/deduction of efficient underspend or overspend; and
- (g) certain investments not funded through PR08, but approved by us for addition to the RAB where the income being received by Network Rail did not include the reimbursement of financing costs (see paragraphs 3.62 to 3.70 for details).

- 3.58 For the avoidance of doubt, the following items will not be adjusted for capitalised financing:

- (a) our PR08 renewals and enhancement assumptions;

- (b) the adjustment for the 25% retention of over/underspend i.e. the adjustment that ensures that the retained benefit or loss of an overspend or underspend is equal to 25%;
- (c) indexation adjustments;
- (d) adjustments for amortisation;
- (e) the RFF; and
- (f) certain investments not funded through PR08, but approved by us for addition to the RAB, where the income being received by Network Rail includes the reimbursement of financing costs (see paragraphs 3.62 to 3.70 for details).

3.59 For the purposes of calculating the appropriate RAB adjustment for capitalised financing, any relevant expenditure should be assumed to have been incurred mid-way through the year. The addition should be calculated with reference to the allowed return assumed in our PR08 determination, i.e. 4.6398%.³⁶

3.60 For the designated categories shown in paragraph 3.57, capitalised financing should therefore be applied using the following formula.

3.61 Capitalised Financing = $[RoR \times (2 \times A + B)] / (2 - RoR)$

where:

A = The opening balance (including capitalised financing);

B = Adjustments during the year;³⁷ and

RoR = The appropriate allowed rate of return (i.e. 4.6398%).

³⁶ This vanilla return is on a semi-annual basis and was used in our PR08 determination for financial modelling purposes and is consistent with the headline annual average return allowed in our PR08 determination of 4.75%.

³⁷ In the case of the effect of the difference between the actual CP4 opening RAB and the assumption we made in our PR08 determination for the opening RAB, the adjustment is treated as being made at the beginning of the first year of CP4, rather than an adjustment during the first year of CP4.

Investments not funded by PR08 but approved by ORR through the investment framework

- 3.62 The investment framework³⁸ is necessary to deal with investments that may arise between access charges reviews (or be required by third parties outside the access charges review framework). This may be as a result of, for example, changing safety requirements, newly developed enhancements to improve Network Rail's performance, or customer requirements for additional outputs. Given that where appropriate these schemes are added to the RAB, the key aspects of our policy are outlined below.
- 3.63 Our investment framework policy has developed over time but we have recently published a document that consolidates all our investment framework policy statements into one document.³⁹
- 3.64 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) government.
- 3.65 Efficient expenditure on schemes promoted by these investors could be logged up by Network Rail for inclusion in the RAB, subject to the criteria set out in the investment framework.
- 3.66 The investment framework allows Network Rail to recover its capital and financing costs for certain schemes through charges, e.g. facility charges for franchised TOC sponsored self-financing schemes. In such cases, capitalised financing will not normally need to be added to the RAB. Where the charges from the scheme include a recovery of the capital costs, amortisation equal to the amount of charge received for the capital costs during the control period (in which the scheme is added to the RAB) will be deducted from the RAB

³⁸ The investment framework is the framework for investments outside the periodic review.

³⁹ Investment framework consolidated policy and guidelines, Office of Rail Regulation, October 2010. This may be accessed at: http://www.rail-reg.gov.uk/upload/pdf/investment_framework_guidelines_october_2010.pdf.

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.

- 3.67 Where appropriate, for example where Network Rail does not receive charges from these schemes reimbursing it for its financing costs in accordance with the investment framework, capitalised financing on the efficient costs should be logged up in accordance with the method detailed in paragraphs 3.57 to 3.61.

Process for adding non-PR08 investment expenditure to the RAB

- 3.68 We expect to make additions to the RAB provided the criteria set out in the investment framework are satisfied.
- 3.69 Once Network Rail (and, if appropriate, the scheme promoter or funder) has confirmed that the scheme outputs have been delivered, Network Rail should then record the expenditure proposed for inclusion in the RAB in statement 3: *Analysis of enhancement capital expenditure* of the regulatory financial statements. When we are satisfied that all the required assurances and information have been provided (we will check that the regulatory financial statements record all investment expenditure incurred in accordance with the criteria and processes set out in our policy framework for investments), the relevant amount will be added to the RAB.
- 3.70 No amount will be added to the RAB in relation to certain schemes if the related access agreements that provide an income stream for Network Rail have not been signed and approved by us.

Reporting of investments

- 3.71 The regulatory financial statement, Statement 2a: *RAB (Regulatory financial position)*, includes the expenditure on all investment schemes for which Network Rail is seeking an addition to the RAB.

Disaggregation of the regulatory financial statements

Disaggregation between England & Wales and Scotland

- 3.72 From 1 April 2006, Scottish Ministers have had responsibility for the strategy and funding of the network infrastructure in Scotland. From 1 April 2006 it has been necessary for Network Rail to report separately for England & Wales

and Scotland its income, operating costs, maintenance, renewals, enhancements, RAB and net debt.

- 3.73 Following a consultation process, in December 2005 we published a document⁴⁰ setting out details of our approach to regulation of the railways in Scotland in response to the new arrangements introduced by the White Paper. In that conclusions document, we said that from PR08 onwards Network Rail's price control will be separated so that we will establish the company's outputs and corresponding revenue requirement separately for England & Wales and Scotland.⁴¹
- 3.74 PR08 determined largely separate price controls for Network Rail's activities in both England & Wales and Scotland in line with separate HLOSs and statements on the public financial resources available ('SoFAs'). Therefore, Network Rail's regulatory financial statements in CP4 will report separate disaggregated information on the company's financial performance in England & Wales and Scotland, as well as in Great Britain as a whole.

Disaggregation by operating route

- 3.75 One of the conclusions of the McNulty Value for Money study and the work on industry structure reform is that there are clear benefits from having a better understanding of the cost of the GB rail industry. It is also difficult to evaluate the success of the GB railway without geographically disaggregated Network Rail accounting information.
- 3.76 There are a number of ways of disaggregating Network Rail's accounting information, e.g. by geographical area, by operating route or by franchisee. There is a general consensus that the best way of disaggregating Network Rail's accounting information is by operating route⁴² because:

⁴⁰ *ORR's approach to regulation in Scotland: Conclusions*, Office of Rail Regulation, December 2005. This may be accessed at <http://www.rail-reg.gov.uk/upload/pdf/267.pdf>.

⁴¹ From 2006-07 onwards Network Rail's regulatory financial statements have reported separate disaggregated information on the company's financial performance in England & Wales and Scotland, as well as in Great Britain as a whole.

⁴² The operating routes are: Anglia, East Midlands, Kent, London North Eastern, London North Western, Scotland, Sussex, Wales, Wessex and Western. Note that Network Rail created a separate operating route for Wales (from parts of Western and London North West operating routes) in 2011-12.

- (a) operating route is the best alignment to the current management responsibility within Network Rail, increasing the proportion of directly attributed costs and hence increasing the ease and speed of implementation;
- (b) the boundaries of the operating routes give a reasonable geographic alignment to train operators and this structure aligns with the current reporting of Scotland; and
- (c) using route level information maximises the amount of directly attributed income and costs and hence ownership of the information at an operating level and should allow a greater focus on efficiency improvements.

3.77 Given these issues, we updated our Guidelines in 2010-11 to require Network Rail to produce accounting information showing its performance by each operating route on a shadow basis.

Regulatory financial statements

3.78 Templates for the regulatory financial statements for England & Wales and for Scotland are set out in annex A. Annex A also includes templates for the regulatory financial statements for each operating route.

Cost allocation

3.79 A high proportion of Network Rail's expenditure on operating, maintaining, renewing and enhancing the network is directly attributable to operating routes and other specific geographic areas, including Scotland. However, some of the company's costs are incurred centrally and are not directly allocated to any geographic area (e.g. information systems costs and human resources costs). Network Rail will need to allocate an appropriate share of its central costs to England & Wales and Scotland, and each operating route

3.80 The rules Network Rail uses for these allocations need to be consistent with the high-level principles and the specific rules set out in annex B.

Financial performance statement⁴³

- 3.81 One of the issues addressed by the McNulty review, the rail franchising review and the DfT review is how to better align incentives in the rail industry. ORR, Network Rail and the Association of Train Operating Companies are also reviewing the potential for cost and revenue sharing mechanisms between Network Rail and train operators that could improve the alignment of incentives.
- 3.82 One of the key issues in setting up a cost and revenue sharing mechanism is determining which income and costs should be included in the mechanism and then once it is set up determining how the companies concerned have performed compared to their targets.
- 3.83 The decisions on the future structure of the rail industry and how a cost and revenue sharing mechanism is constructed directly affect how we will need to calculate and report on Network Rail's financial performance. We also made a number of changes in PR08 to some of our policies that impact on the treatment of outperformance and underperformance. Therefore, after the work on cost and revenue sharing mechanisms has been completed and we have considered how the emerging conclusions on industry reform could affect the position, we will update our underspend framework document.
- 3.84 The updated underspend framework document will set out our policies on outperformance, details of the calculations required for the financial performance statement and how Network Rail's financial performance should be reported. In the meantime we will continue to report on Network Rail's financial performance for the purpose of our PR08 efficiency benefit sharing mechanism in our annual efficiency and finance assessment.
- 3.85 It is important that the calculations of outperformance are transparent and consistent with the rules we set out in our underspend framework. Therefore, in future the regulatory accounts will include a financial performance statement that will assess Network Rail's financial performance against our

⁴³ In January 2006 we set out our policy on how an outperformance by Network Rail of CP3 should be treated. In CP3, Network Rail according to its own calculations outperformed by £1.2bn (2008-09 prices). As a result of this outperformance, Network Rail identified £200m to be spent on investment projects that should benefit railway users (i.e. its outperformance fund). By the end of CP3, Network Rail had spent all of this money and the rest of the outperformance has effectively been used to pay down debt.

PR08 assumptions, including income, expenditure, financing and the financial benefit of incentive mechanisms. It will also identify the amounts available for our PR08 efficiency benefit sharing mechanism.⁴⁴

- 3.86 However, the final version of the financial performance statement cannot be completed until after the consultation on the underspend framework.

Corporation tax

- 3.87 In our PR08 determination, we changed our approach to determining Network Rail's allowed return and allowed Network Rail a vanilla based return.⁴⁵ This approach means that we fund separately Network Rail's corporation tax liabilities as described in our PR08 determination.⁴⁶ This means that we need to collect information on Network Rail's corporation tax liabilities to monitor CP4 and inform future access reviews, e.g. Network Rail's corporation tax computation.

Opex memorandum account

- 3.88 As set out in our PR08 determination and related documents, Network Rail needs to include any payments due under the volume incentive and any appropriate under/over spends on Cumulo rates, ORR fees,⁴⁷ reporter costs and NSIP in the opex memorandum account. This account will be reported on in statement 10: *Other information* of the regulatory financial statements and for the avoidance of doubt this account is not part of the RAB and no capitalised financing is added to the account in CP4. Any adjustments to revenue will be made at the next periodic review (to take effect from 1 April 2014).

Net debt and financial ratios

- 3.89 The purpose of the net debt and financial ratios statement is to assess Network Rail's performance in England & Wales and Scotland against its

⁴⁴ See paragraphs 27.23 to 27.54 of our PR08 determination for more information.

⁴⁵ A 'vanilla return' is based on a pre-tax cost of debt and a post-tax cost of equity.

⁴⁶ See paragraphs 14.87 to 14.115 of the PR08 determination.

⁴⁷ ORR fees include the ORR licence fee and the railway safety levy.

regulatory assumptions for net debt and the financial assumptions that underpinned our PR08 determination.

Network Rail (CTRL) Limited

- 3.90 HS1 Limited has contracted with Network Rail (CTRL) Limited for it to operate, maintain and renew the High Speed 1 line. Most of the resources that Network Rail (CTRL) Limited uses to carry out these activities are provided by Network Rail.
- 3.91 Therefore, it is important that the charges that Network Rail makes to Network Rail (CTRL) 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.
- 3.92 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 (CTRL) 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.

Monitoring and treatment of Network Rail's underspend and efficiency

- 3.93 We published a policy statement on the monitoring and treatment of Network Rail's underspend and efficiency in January 2006.⁴⁸ Although the document primarily refers to Control Period 3 (CP3), the policy intent is maintained.

⁴⁸ This is available at <http://www.rail-reg.gov.uk/server/show/nav.68>.

Annex A: Required statements and disclosures

Statements (unless we say otherwise the information required by this annex will be published in Network Rail's regulatory accounts and covered by the audit opinion)⁴⁹

*Primary regulatory financial statements (for Great Britain, England & Wales and Scotland).*⁵⁰

1. Regulatory financial performance – for current and prior year and a cumulative total.

2. RAB analysis:

- (a) RAB (regulatory financial position) - summary of Network Rail's RAB for each year of CP4;
- (b) RAB - reconciliation of expenditure – a reconciliation of the difference between our PR08 assumptions contained in our PR08 determination for renewals and enhancements, the RAB additions and actual expenditure, a summary of the breakdown of the key elements of renewals and enhancement under/over spend and the balance on non-capex RAB additions. This regulatory financial statement will not be published in Network Rail's regulatory accounts; and
- (c) RAB – a summary of the movements in Network Rail's RAB for each year of CP4.

Other regulatory financial statements (for Great Britain, England & Wales and Scotland):

3. Analysis of enhancement capital expenditure - for current and prior year of CP4 and a cumulative total.

⁴⁹ The commentaries that are included on the regulatory financial statements will be subject to a review by the auditors and not an audit.

⁵⁰ These statements are referred to as "primary statements" for the purposes of Condition 11.

4. Net debt and financial ratios - for current and prior year of CP4 and a cumulative total.

5. Financial performance - for each year of CP4 and a cumulative total. This regulatory financial statement will not be covered by the audit opinion for 2011-12 but will be reviewed by the reporters and/or auditors.

6. Analysis of Income:

- (a) Analysis of income - for current and prior year of CP4 and a cumulative total;
- (b) Analysis of other single till income - for current and prior year of CP4 and a cumulative total. This regulatory financial statement will not be published in Network Rail's regulatory accounts; and
- (c) Analysis of income by operator - for current and prior year of CP4 and a cumulative total.

7. Analysis of operating expenditure:

- (a) Analysis of operating expenditure - for current and prior year of CP4 and a cumulative total;
- (b) Analysis of operating expenditure by activity (to be provided for each year of CP4 and a cumulative total). This regulatory financial statement will not be published in Network Rail's regulatory accounts or covered by the audit opinion but will be reviewed by the auditors;
- (c) Insurance reconciliation – for current year and a cumulative total. This regulatory financial statement will not be published in Network Rail's regulatory accounts or covered by the audit opinion for 2011-12 but will be reviewed by the auditors; and
- (d) Overhead reconciliation - for current and prior year of CP4 and a cumulative total. This regulatory financial statement will not be covered by the audit opinion but will be reviewed by the auditors.

8. Analysis of maintenance expenditure:

- (a) Summary - for current and prior year of CP4 and a cumulative total; and

- (b) Analysis of maintenance expenditure by Maintenance Delivery Unit ('MDU') - for current and prior year of CP4 and a cumulative total. This regulatory financial statement will not be covered by the audit opinion but will be reviewed by the auditors.

9. Analysis of renewals expenditure - for each year of CP4 and a cumulative total:

- (a) Summary statement - for current and prior year of CP4 and a cumulative total; and
- (b) Detailed statement - for current and prior year of CP4 and a cumulative total. This regulatory financial statement will not be covered by the audit opinion but will be reviewed by the auditors.

10. Other information, e.g. items remunerated through the opex memorandum account and a breakdown of schedule 4 and 8 income and costs - for each year of CP4.

11. Analysis of Network Rail charges to Network Rail CTRL for work on HS1 - for each year of CP4. This regulatory financial statement will not be published in Network Rail's regulatory accounts but will be reviewed by the auditors.

12. Analysis of Network Rail's efficiency. This regulatory financial statement will be reviewed by the reporters.

13. Analysis of Network Rail's performance on the volume incentive. This regulatory financial statement will be reviewed by the reporters.

14 - 15. Analysis of Network Rail's maintenance and renewals unit costs. These regulatory financial statements will be reviewed by the reporters.

Note: At the moment we do not require any additional accounting information to be provided for NRIF, in addition to the requirements of paragraph 2.4 of chapter 2.

Other disaggregated regulatory financial statements (statements 1 to 8 will be provided for each operating route, and statements 9 and 10 will be provided by strategic route).⁵¹

⁵¹ Note: The total of the operating routes will be equal to Network Rail in total. ~~operating route and part of the North Western operating route.~~

1. Regulatory financial performance (statement R1 in the template).
2. Enhancements expenditure (statement R3 in the template).
3. Income (statement R6a in the template).
4. Operating expenditure (statement R7a in the template).
5. Maintenance expenditure (statement R8a in the template).
6. Renewals expenditure (statement R9a in the template).
7. Analysis of schedule 4 and 8 income (statement R10 in the template).
8. Volume incentive (statement R13 in the template).
9. Analysis of maintenance expenditure by strategic route (statement R18 in the template).
10. Analysis of renewals expenditure by strategic route (statement R19 in the template).

Other required disclosures for each year (for Great Britain and where relevant England & Wales and Scotland):

1. Supporting notes as appropriate.
2. Accounts prepared under the Companies Act 2006 (including relevant statements procured from Network Rail Infrastructure Finance PLC).
3. Reconciliations with statutory accounts, e.g. for opex, RAB and net debt and including disclosure of the breakdown of the adjustment for reactive and cyclical maintenance (excluding structures inspections), separately identifying total operational property maintenance and stations maintenance.
4. Reconciliation of net debt per the regulatory accounts with net debt per the definition in network licence condition 3: Level of financial indebtedness.
5. Statement of adequacy of management and financial resources and the related statement confirming that Network Rail is not aware of any changes to its forecasts that would have a material effect on the forward looking financial ratios. This regulatory financial statement will not be covered by the audit opinion for 2010-11 but will be reviewed by the auditors.

6. Statement under network licence condition 3 in relation to the level of financial indebtedness.
7. Auditors'/reporter reports.
8. Income and expenditure statements for each managed station. This information will not be published in Network Rail's regulatory accounts or covered by the audit opinion for 2011-12 but will be reviewed by the auditors.
9. Corporation tax computation. This information will not be published in Network Rail's regulatory accounts or covered by the audit opinion.
10. Other (see paragraph 2.28).

Publication and audit

This annex and the spreadsheet: RAGs – template regulatory financial statements 2011-12 contain details of the information for 2011-12 that will be published by Network Rail and covered by the audit opinion. This annex and the spreadsheet: RAGs – template regulatory financial statements 2011-12 also contain the details of the information that will only be provided to us and be subject to a review by the auditors or the reporter as appropriate for 2011-12. For the avoidance of doubt unless we say otherwise the information will be published and covered by the audit opinion.

Network Rail would not be required to include in the published regulatory accounts (although the information would still be provided to us) an item where publication would or might seriously and prejudicially affect the interests of Network Rail. For this purpose Network Rail shall (except so far as we consent to Network Rail not doing so) refer for determination by us any question as to whether any such publication would or might seriously and prejudicially affect the interests of Network Rail.

Template regulatory financial statements

The template regulatory financial statements are included in the spreadsheet: RAGs – template regulatory financial statements 2011-12.⁵² Unless otherwise agreed with us, monetary amounts included in the regulatory financial statements should be

⁵² *RAGs – template regulatory financial statements 2011-12*. This may be accessed at <http://www.rail-reg.gov.uk/server/show/nav.149>.

resented in £m to zero decimal places⁵³ and percentages and ratios should be presented to two decimal places.

⁵³ Except for statement 6c for Great Britain, England & Wales and Scotland, which should be presented in £m to one decimal place.

Annex B: Guidelines for preparing the regulatory accounts

Income

1. The following guidelines should be applied when preparing the regulatory accounts.
2. Unless we agree, income will be recorded in the regulatory accounts on the same basis as it was treated in our 2008 periodic review ('PR08') determination. In certain cases the income will be presented differently in Network Rail Infrastructure Limited's ('Network Rail's') statutory accounts in order to comply with financial reporting standards. For the avoidance of doubt, it is for Network Rail to decide what information it includes in its statutory accounts.
3. In the event that the basis of allocating income between any of the sub-categories changes, the fact should be disclosed in the narrative to the regulatory accounts.
4. Network Rail is required to analyse its income on a basis that is consistent with the categorisation used in our PR08 determination except for the categorisation of other single till income which is more disaggregated.
5. Total income consists of franchise access income, grant income, rebates and other single till income. For the avoidance of doubt it does not include investment income.
6. Other single till income, includes the following types of income :
 - (a) property income – revenue generated from the licensee's non-operational property portfolio, including the proceeds of disposals. This includes income from investment schemes such as shared value,⁵⁴ hypothecated income⁵⁵ and development gains;⁵⁶

⁵⁴ Shared value is where Network Rail takes a share of the gains generated by a development which benefits from access rights to its land. In general, the uplift in value from a shared value scheme will take the form of additional revenue to Network Rail, and/or a corresponding increase in the value of Network Rail's assets. If there is a demonstrable increase in the value of Network Rail's assets, the value of this increase

- (b) freight income – net income from track access charges paid by freight train operators.
- (c) open access income – net income from track access charges paid by passenger train operators not operating under any form of franchise agreement;
- (d) stations income – net income from station access agreements;
- (e) depots income – net income from depot access agreements;
- (f) third party funded enhancement schemes – income from payments made by customers specifically in relation to enhancement schemes; and
- (g) other – other single till income generated by the licensee from sources other than those described above. For the avoidance of doubt it does not include investment income.

Expenditure

General

7. The following guidelines should be applied when preparing the regulatory accounts.
8. Unless we agree, expenditure will be recorded in the regulatory accounts on the same basis as it was treated in our PR08 determination. In a number of cases this basis will be the approach adopted in Network Rail's 2006-07 regulatory accounts. The main exception to this rule is that the classification of operating and maintenance expenditure will be on the same basis as in Network Rail's updated delivery plan published in early 2011.

would be eligible in principle for addition to the RAB, assuming that the additional revenue from the scheme was sufficient to cover the additional return on the RAB and that the increase meets our criteria for efficiency.

⁵⁵ Where a developer offers to carry out an enhancement in return for, for instance, acquiring Network Rail land for development. In order to provide incentives on Network Rail to seek further gains where appropriate, a proportion of any hypothecated gains over and above the forecast in our PR08 determination of £255m (in 2006-07 prices) will be eligible for addition to Network Rail's RAB.

⁵⁶ Development gains are gains other than gains from shared value or hypothecated gains.

9. In Network Rail's 2009-10 internal reporting it revised its definitions of operating costs and maintenance. In its 2010-11 internal reporting it made a further adjustment to the definition of operating costs and maintenance. The changes only affect operating costs and maintenance. In this situation it will be easier to compare our PR08 determination to Network Rail's revised definitions of operating costs and maintenance costs for control period 4 (CP4), so we have restated the operating cost and maintenance cost assumptions in our PR08 determination as shown in the table below to be on the same basis as Network Rail's revised definitions. Network Rail does not expect to make any further material changes to the definition of operating costs and maintenance in CP4.
10. This restatement has no effect on Network Rail's income and has been done to simplify the reporting process. In certain cases the costs will be presented differently in Network Rail's statutory accounts in order to comply with financial reporting standards.
11. In the event that the basis of allocating expenditure between any of the sub-categories changes, the change should be disclosed in the narrative to the regulatory accounts.

Table 1: Restatement of operating and maintenance expenditure included in our PR08 determination

	PR08			Restated for 2009-10			Restated for 2010-11		
(£m, 2006-07 prices)	GB	EW	S	GB	EW	S	GB	EW	S
2009-10									
Operating	722	656	66	782	711	71	730	664	66
Maintenance	1,091	988	103	1,031	933	98	1,083	980	103
Total	1,814	1,644	169	1,814	1,644	169	1,814	1,644	169
2010-11									
Operating	702	638	64	761	691	69	710	645	65
Maintenance	1,047	947	99	988	894	94	1,039	940	98
Total	1,749	1,585	164	1,749	1,585	164	1,749	1,585	164
2011-12									
Operating	674	612	62	730	664	66	684	622	62
Maintenance	1,000	905	95	944	853	91	990	895	95
Total	1,674	1,517	157	1,674	1,517	157	1,674	1,517	157
2012-13									
Operating	647	588	59	701	637	64	656	596	60
Maintenance	960	868	91	906	819	87	951	860	91
Total	1,607	1,456	151	1,607	1,456	151	1,607	1,456	151
2013-14									
Operating	621	564	57	673	612	61	629	572	57
Maintenance	918	830	88	866	783	84	910	823	88
Total	1,539	1,394	145	1,539	1,394	145	1,539	1,394	145

Note: There will be small rounding differences in the above table.

Renewals expenditure

12. For regulatory accounts purposes renewals expenditure consists mainly of capital expenditure projects where the existing infrastructure is replaced with new assets. Costs incurred in replacing an existing asset or components of an existing asset should be recorded as renewals expenditure. Such expenditure does not result in any change or enhancement of the performance of the original asset.
13. Network Rail's reactive and cyclical expenditure (excluding structures inspections) on structures and operational property should be categorised as renewals expenditure in order to be consistent with the treatment adopted in our PR08 determination. This includes reactive and cyclical expenditure (excluding structures inspections) on:
 - (a) underbridges, overbridges, footbridges, earthworks, coastal and estuarial defences, culverts, retaining walls and tunnels; and
 - (b) stations, depots and lineside buildings.
14. The templates for this analysis are shown in Statement 9a: *Summary analysis of renewals expenditure* and Statement 9b: *Detailed analysis of renewals expenditure*.

Enhancements

15. Enhancement expenditure is defined as capital expenditure resulting in a change to network outputs, usually involving construction, which improves network capacity or capability (e.g. enabling higher speeds, allowing heavier loads) relative to the level of network outputs funded at the last relevant periodic review. Usually outputs are required at specific times (in contrast to most renewals). Enhancements costs are reported separately as shown in Statement 3: *Analysis of enhancement capital expenditure*.

Maintenance

16. Maintenance expenditure relates to activities that Network Rail carries out in order to sustain the condition and capability of the existing infrastructure but which does not involve significant replacement of assets. Such expenditure maintains the previously assessed standard of performance.
17. Maintenance expenditure 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.

18. The templates for this analysis are shown in Statements 8a: *Analysis of maintenance expenditure* and statement 8b: *Analysis of maintenance expenditure by MDU*.

Operating expenditure

19. Operating expenditure represents total operating expenditure consistent with our PR08 final determination, apart from the reclassification discussed in paragraphs 9 to 10 of annex B. Operating expenditure will include operations costs, other controllable operating costs, e.g. insurance, and non-controllable operating costs, e.g. cumulo rates. Operating expenditure will include Network Rail Insurance Limited's total profit/loss from operations. Details of Network Rail Insurance Limited's total profit/loss from operations, investment revenues, finance costs, profit/loss before tax, tax and profit/loss for the year attributable to equity shareholders will be provided in a note to Network Rail's regulatory accounts.
20. Unless we agree otherwise, the definitions of activities - e.g. the definition of HR - are per Network Rail's PR08 submissions.
21. For the period to 31 March 2014 non-controllable operating expenditure consistent with our PR08 final determination includes the following items:
- (a) traction electricity costs;
 - (b) cumulo rates;
 - (c) British Transport Police costs;
 - (d) Rail Safety and Standards Board levy;

- (e) ORR fees; and
 - (f) Other, i.e. the CIRAS fee.
22. No other operating expense should be classified as non-controllable expenditure.
23. The templates for the analysis of operating expenditure are shown in Statement 7a: *Analysis of operating expenditure*, Statement 7b: *Analysis of operating expenditure by activity*, Statement 7c: *Insurance reconciliation* and Statement 7d: *Overhead reconciliation*.

High-level principles

24. The high-level principles that Network Rail needs to use when preparing its regulatory accounts are:
- (a) Causality. Income and costs should be allocated in relation to the activities which cause the income to be earned or the costs to be incurred;
 - (b) Objectivity. The regulatory accounts will be prepared without unduly prejudicing Network Rail or any part of Network Rail or any other entity;
 - (c) Consistency. Where practicable the regulatory accounts should be prepared on a consistent basis from year to year and when there are changes to the Guidelines, Network Rail should restate the previous years regulatory accounts; and
 - (d) Transparency. All the methods used to prepare the regulatory accounts including the methods used to allocate income and costs between each operating route should be transparent.
25. In order to compare Network Rail's performance with the Determination Assumptions, it is necessary for Network Rail to prepare its regulatory accounts on a basis that is consistent with our PR08 determination with the exception of the change to the classification of operating expenditure and maintenance expenditure as discussed in paragraphs 9 to 10 of annex B. This in practice largely means that when preparing the regulatory accounts Network Rail needs to use the accounting policies that it used when preparing its 2006-07 regulatory accounts.

Disaggregated operating route accounting principles

26. Network Rail's disaggregated operating route regulatory financial statements will be covered by the audit opinion and published from 2011-12. In preparing these regulatory financial statements, Network Rail will need to follow our high-level principles as set out in paragraph 24 and Network Rail will need to explain to us any material changes in the approach that it takes to allocate income and expenditure between operating routes.
27. Our understanding is that Network Rail's approach is as follows:
28. Network Rail's income and expenditure are classified into the following three main categories dependent upon how the items are managed:
 - (a) directly attributed - route managed. Income and expenditure in this category is currently managed at route level, e.g. signallers. As there is alignment between management responsibility and route, such items are relatively straightforward to account for at route level;
 - (b) centrally managed - attributable to routes. Income and expenditure in this category is not currently managed at route level, e.g. route based teams managed outside of the operations and maintenance functions. However, even though the management responsibility may not be locally based the income is earned and costs are incurred locally, so attributing these items to routes should be relatively straightforward. The main issue is likely to be that some maintenance and renewals projects cover more than one route or are network-wide, so some apportionment may be required for cross-route/network-wide projects; and.
 - (c) centrally managed – network wide. Income and expenditure in this category is incurred for the whole network or company as a whole, e.g. insurance costs. These items can only be allocated to a route by apportioning the income and expenditure across the routes.
29. Network Rail has said that direct attributed - route managed income and expenditure includes:
 - (a) TOC fixed track access income (although it needs to be allocated from TOC to route);

- (b) TOC variable track access income;
 - (c) managed stations income (non-retail);
 - (d) signallers;
 - (e) route management team (customer relationship executives and route enhancement managers etc);
 - (f) managed stations operations & maintenance costs;
 - (g) other operations costs;
 - (h) maintenance delivery units;
 - (i) other maintenance costs of the main asset types, e.g. track, signalling, telecoms, electrification and plant and machinery;
 - (j) route maintenance teams;
 - (k) National delivery service – operations delivery; and
 - (l) Asset management – inspections and information collection.
30. Network Rail has said that centrally managed – attributable to routes income and expenditure includes:
- (a) income – station retail, property rent and property development and sales;
 - (b) traction electricity (income and cost);
 - (c) maintenance - operational telecoms contracts;
 - (d) renewals and enhancements (although some apportionment may be required for cross-route/network-wide projects) and asset management including structures examination and assessment;
 - (e) National delivery service – stock management and rail grinding;
 - (f) corporate services – route based finance support and route based human resources support; and
 - (g) central costs – e.g. redundancy.

31. Network Rail has said that centrally managed – network wide income and expenditure includes:
- (a) operations and customer services – train planning, performance analysis, HQ operations & customer services and stations development;
 - (b) property – offices & accommodation;
 - (c) maintenance - property (including operational and non-operational) and structures maintenance and HQ Maintenance teams;
 - (d) asset management – engineering strategies & policies, CP5 planning and business improvement;
 - (e) National delivery service – management team and fleet maintenance;
 - (f) corporate services – finance (non-route based), human resources (non-route based), information management & corporate development, planning and regulation, legal and board and government & corporate affairs; and
 - (g) central – insurance and property and support recharges to projects.
32. The grouping of the above income and costs into the different types above could change as Network Rail refines its methods of preparing the regulatory financial statements for each operating route.

Annex C: Condition 3 and 11 of Network Rail's network licence

Condition 3: Financial indebtedness

- 3.1 Except with the written consent of ORR, the licence holder shall use reasonable endeavours to ensure that at any time the total amount of financial indebtedness of the licence holder, any subsidiaries of the licence holder, Network Rail Infrastructure Finance and any subsidiaries of Network Rail Infrastructure Finance shall not exceed the limits applicable at that time that are shown in table 3.1 which are determined by dividing that financial indebtedness by the Value of the RAB at that time.

Table 3.1: Limits to the level of financial indebtedness expressed as a percentage of the Value of the RAB

Financial year	Limit
2009-10	70.0%
2010-11	70.0%
2011-12	72.5%
2012-13	75.0%
2013-14	75.0%

- 3.2 If at any time the total aggregate amount of financial indebtedness of the licence holder, any subsidiaries of the licence holder, Network Rail Infrastructure Finance and any subsidiaries of Network Rail Infrastructure Finance exceeds the limits set out in condition 3.1 applicable to that financial year the licence holder shall, within such time periods as ORR may notify as being appropriate in the circumstances:
- (a) provide to ORR details of the steps it intends to take to reduce the amount to those limits or below;
 - (b) take those steps; and
 - (c) provide to ORR evidence that it has taken those steps.

3.3 The licence holder shall:

- (a) provide, from time to time as requested by ORR and in any event every year in the regulatory financial statements the licence holder prepares pursuant to condition 11, confirmation that, in respect of the financial year to which the statements relate, it has complied, and, in respect of the following financial year, it is not aware of any circumstances which will prevent it complying and it is likely to comply, with condition 3.1 and (where applicable) condition 3.2 and, if so requested by ORR, evidence in support of that confirmation; and
- (b) notify ORR immediately in writing if at any time the licence holder becomes aware of any circumstance that means it is no longer complying, or that causes it no longer to have the reasonable expectation that it is likely to comply, with condition 3.1 and (where applicable) condition 3.2.

3.4 The licence holder shall pay to the Secretary of State, at least annually, a fee in respect of the state financial indemnity.

3.5 In this condition:

- “fee” means the amount equal to 0.8 per cent (on an annual basis) of the daily outstanding amount of financial indebtedness incurred by Network Rail Infrastructure Finance and which is supported by the state financial indemnity;
- “financial indebtedness” means the sum of:
- (a) all financial liabilities arising from all transactions (including any forward sale or purchase agreement) which have the commercial effect of a borrowing;
 - (b) any counter-indemnity obligation in respect of any guarantee, indemnity, bond, letter of credit or any other instrument issued by a bank or financial institution; and

- (c) any guarantee, indemnity or similar assurance against financial loss of any person in respect of any item referred to in paragraph (a);

less

- (d) cash and cash equivalents which are assets or investments that are held for the purpose of meeting short-term cash commitments or other investments with a maturity of twelve months or less for the purpose of pre-funding the repayment of financial indebtedness.

For the purposes of this condition:

- (a) financial indebtedness excludes:
 - (i) any financial indebtedness between the licence holder or any of the licence holder's subsidiaries and Network Rail Infrastructure Finance or any of Network Rail Infrastructure Finance's subsidiaries;
 - (ii) any financial indebtedness between the licence holder and any of its subsidiaries;
 - (iii) any financial indebtedness between any of the licence holder's subsidiaries;
 - (iv) any financial indebtedness between Network Rail Infrastructure Finance and any of its subsidiaries; and
 - (v) any financial indebtedness between any of Network Rail Infrastructure Finance's subsidiaries;
- (b) financial indebtedness is:
 - (i) calculated by reference to the principal amount outstanding of any such financial indebtedness

(and no mark to market value will be used to calculate its amount); and

- (ii) measured as specified in the regulatory accounting guidelines, issued in accordance with condition 11, in force at the applicable time;
- (c) where financial indebtedness denominated in a foreign currency is hedged by a foreign currency derivative transaction protecting against or benefiting from fluctuations in foreign exchange rates, the principal amount outstanding shall be calculated by reference to the sterling amount payable under the relevant derivative;

“Network Rail Infrastructure Finance”

has the meaning given to it by condition 4.33;

“state financial indemnity”

means the financial indemnity provided by the Strategic Rail Authority on 29 October 2004 (and transferred to the Secretary of State on 26 June 2005), which is available until 2052; and

“Value of the RAB”

means the value of the licence holder’s assets calculated in accordance with the regulatory accounting guidelines, issued in accordance with condition 11, in force at the applicable time.

Condition 11: Regulatory accounts

Purpose

- 11.1 The purpose of this condition 11 is to procure the provision of annual information on the financial performance and financial position of the licence holder, Network Rail Infrastructure Finance and any subsidiaries of Network Rail Infrastructure Finance which:
- (a) is relevant to ORR and other persons for the assessment and determination of the licence holder's access charges; and
 - (b) allows the financial performance and financial position of the licence holder to be monitored against the Determination Assumptions.

General duty

- 11.2 To achieve the purpose in condition 11.1, the licence holder shall prepare regulatory financial statements in relation to itself and, unless ORR otherwise consents, to Network Rail Infrastructure Finance in accordance with the following paragraphs of this condition 11 and any Regulatory Accounting Guidelines from time to time issued by ORR.
- 11.3 The licence holder shall, and shall procure that any affiliate or related undertaking of the licence holder and Network Rail Infrastructure Finance shall, maintain such accounting records, other records and reporting arrangements as are necessary to enable the licence holder to properly prepare the regulatory financial statements required by condition 11.2. The licence holder shall maintain all systems of control and other governance arrangements that ensure the information collected and reported to ORR is in all material respects accurate, complete and is fairly presented and that all control and other governance arrangements are kept under regular review by the directors of the licence holder so that they remain effective for this purpose.

Specific obligations

- 11.4 The financial statements referred to in condition 11.2:
- (a) shall be prepared in respect of the financial year ended 31 March 2002 and (save as otherwise provided in this condition 11 or the Regulatory

Accounting Guidelines) on a consistent basis in respect of each financial year;

- (b) shall be prepared such that, so far as is reasonably practicable, the definition of items in primary statements; the valuation of assets and liabilities; the treatment of income and expenditure as capital or revenue; adjustments in respect of the provision, utilisation, depreciation and amortisation of assets and liabilities; and any other relevant accounting policies shall be consistent with:
 - (i) ORR's valuation of the Regulatory Asset Base for the purpose of determining access charges for the access review periods specified in the Regulatory Accounting Guidelines; and
 - (ii) the Determination Assumptions for the access review periods specified in the Regulatory Accounting Guidelines;(and so that where the presentation of an item in the primary statements departs from the basis for the Regulatory Asset Base or the Determination Assumptions, a reconciliation shall be included by way of a note);
- (c) shall include, as a primary statement, a statement of regulatory financial performance comparing income and expenditure, for the access review periods specified in the Regulatory Accounting Guidelines with the Determination Assumptions;
- (d) shall include all details reasonably necessary to reconcile items included in the primary statements with any corresponding items in annual statutory accounts for the access review periods specified in the Regulatory Accounting Guidelines; and
- (e) shall include narrative explaining the material variances from the previous year and from the Determination Assumptions.

Sufficiency of resources

11.5 The licence holder shall make a statement, which shall be approved by a resolution of the board of directors of the licence holder and signed by a director of the licence holder pursuant to that resolution, certifying the adequacy (or otherwise) of the management and financial resources,

personnel, fixed and moveable assets, rights, licences, consents and facilities of the licence holder for the period of 12 months commencing on the date of the statement.

11.6 The statement made under condition 11.5 shall be in one of the following forms:

either:

- (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.”

11.7 The licence holder shall submit to ORR details of the main factors which the directors of the licence holder have taken into account in making the statement under condition 11.5 and the information specified in the Regulatory Accounting Guidelines. In the case of a statement of the kind contemplated by condition 11.6(b) the licence holder shall also submit with the statement a description of the factors which may cast doubt on the ability of the licence holder to carry on the activities authorised by this licence.

11.8 The licence holder shall -

- (a) notify ORR in writing immediately if its directors become aware of any circumstance that causes them no longer to have the reasonable expectation expressed in the most recent statement made under condition 11.5 in the forms set out in condition 11.6; and
- (b) subject to complying, as if it were a company whose ordinary shares are for the time being admitted to the Official List of the UK Listing Authority, with the listing rules of the Financial Services Authority acting in its capacity as a competent authority for the purposes of Part VI of the Financial Services and Markets Act 2000, publish its notification to ORR in such form and manner as ORR may direct. This notification will include the information specified in the Regulatory Accounting Guidelines in relation to the operation of the re-opener provisions.

Regulatory Accounting Guidelines

11.9 ORR may from time to time issue Regulatory Accounting Guidelines, which may:

- (a) further specify the accounting policies, format and content of the financial statements and the matters to be shown or reported in them;
- (b) provide for appropriate segmental analysis and/or further breakdown of any items contained in the financial statements;
- (c) provide for specification or description of any transactions or arrangements between the licence holder and any affiliate or related undertaking (including, without limitation, so as to enable ORR to monitor compliance with the conditions of this licence);
- (d) further include provision requiring the licence holder to prepare and publish information in respect of proposed enhancements which the licence holder shall log up as enhancement expenditure, and annually, information on those enhancements actually made; and
- (e) specify the provision and/or publication of such other information as ORR may reasonably require in order to monitor the licence holder's financial performance and financial position or assist in the determination of the licence holder's access charges.

Auditors

11.10 The licence holder shall procure a report by the Auditors addressed to ORR:

- (a) stating whether, in their opinion, the regulatory financial statements (other than those referred to in condition 11.10(c)) and information on proposed enhancements have been prepared in accordance with this condition, including Regulatory Accounting Guidelines;
- (b) stating whether, in their opinion, the regulatory financial statements present fairly the financial performance and financial position of the licence holder and (to the extent that they relate to Network Rail Infrastructure Finance) of Network Rail Infrastructure Finance in accordance with this condition and any Regulatory Accounting Guidelines; and
- (c) stating whether the information on enhancement expenditure produced in accordance with condition 11.9(d) has been prepared in accordance with the Regulatory Accounting Guidelines and is consistent with such expenditure presented in the primary financial statements.

11.11 Each statement made under condition 11.5 shall be accompanied by a report prepared by the Auditors and addressed to ORR, stating whether the Auditors are aware of any inconsistencies between that statement and any supporting statements and either the financial statements referred to in condition 11.2 or any information which the Auditors obtained in the course of their audit work for the licence holder and, if so, the report of the auditors should state what the inconsistencies are.

11.12 The licence holder shall enter into a contract of appointment with the Auditors which shall include a term that the Auditors will provide such further explanation or clarification of their reports and such further financial information in respect of the matters which are the subject of their reports as ORR may reasonably require for the exercise of its functions, including, in relation to monitoring, compliance by the licence holder with the conditions of this licence.

Publication and provision of information

- 11.13 The licence holder shall deliver to ORR a copy of the financial statements together with any information provided for in the Regulatory Accounting Guidelines, the Auditors' report referred to in condition 11.10 and the statement referred to in condition 11.5 as soon as reasonably practicable and in any event not later than 1 July following the end of the financial year to which they relate (or a later date approved by ORR). The financial statements, information, the Auditors' report referred to in condition 11.10 and the statement referred to in condition 11.5, subject to any modifications approved by ORR, (including the deletion of any information the publication of which ORR is satisfied would or might seriously and prejudicially affect the interests of the licence holder or any other person), shall be published within one calendar month of delivery to ORR and then made available to any member of the public on request.
- 11.14 With a view to enabling the licence holder to comply with its obligations under condition 11.2, the licence holder shall, unless ORR otherwise consents, procure from Network Rail Infrastructure Finance a legally enforceable undertaking or undertakings in favour of the licence holder which shall require Network Rail Infrastructure Finance to prepare and give to the licence holder financial statements in relation to Network Rail Infrastructure Finance and its subsidiaries in such a form and covering such periods as may be specified in any Regulatory Accounting Guidelines from time to time issued by ORR.
- 11.15 The licence holder shall:
- (a) deliver to ORR evidence (including a copy of all such undertakings) that the licence holder has complied with the obligation to procure any undertaking pursuant to condition 11.14;
 - (b) inform ORR immediately in writing if the directors of the licence holder become aware that any undertaking procured pursuant to condition 11.14 has ceased to be legally enforceable or that its terms have been breached; and
 - (c) comply with any direction from ORR to enforce any of the undertakings procured pursuant to condition 11.14.

11.16 In this condition:

“Auditors”	means the person appointed by the licence holder for the purpose of reporting on the regulatory financial statements referred to in this condition 11;
“Determination Assumptions”	means any assumptions (including their definitions and bases of measurement) from time to time notified to the licence holder by ORR as assumptions that have been used for determining access charges;
“Network Rail Infrastructure Finance”	has the meaning given to it by condition 4.33;
“Regulatory Accounting Guidelines ”	means any guidelines issued by ORR from time to time in accordance with condition 11.9;
“Regulatory Asset Base”	means the value of the licence holder for regulatory purposes.

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