



OFFICE OF **RAIL REGULATION**

**Railways Act 1993 (as amended)
Network Licence held by Network Rail
Infrastructure Limited
Condition 22 – Regulatory accounts**

REGULATORY ACCOUNTING GUIDELINES

JULY 2006

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1. Overview

Introduction

- 1.1 These Regulatory Accounting Guidelines (Guidelines) are issued pursuant to Condition 22 of the Network Licence (Condition 22) held by Network Rail Infrastructure Limited (Network Rail)¹.
- 1.2 Network Rail is the operator of the national railway network. Its main business is the operation, maintenance, renewal and enhancement of the 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. Their main purpose is to inform the determination of access charges and to monitor compliance with the most recent review of access charges. Good quality accounting information is important to effective regulation and helps ensure that the interests of customers and funders are properly protected. It enables robust financial monitoring of Network Rail and is useful to the Office of Rail Regulation (ORR), funders and other interested parties for these purposes.
- 1.4 These Guidelines were re-issued in May 2005 to rationalise and improve Network Rail's regulatory accounts so that they provide simplified, clearer financial information in a form useful to us and other users, which can be published each year in an appropriate format. We are now updating the Guidelines to ensure that they reflect new policies that we have implemented since they were last re-issued. In particular, these amended Guidelines reflect our approach to disaggregation of Network Rail's price control arrangements to support the devolution of responsibility for rail strategy and funding in Scotland to Scottish Ministers.

¹ Condition 22 is given in full in Annex D to these Guidelines.

- 1.5 Network Rail is required by paragraph 10 and paragraph 12 of Condition 22 and paragraph 3 of Condition 29 to provide to us with the following information, which together comprises the regulatory accounts:
- the regulatory financial statements, with 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 29 of its Network Licence on its compliance with ORR's set limits on its financial indebtedness.
- 1.6 The remainder of this chapter provides an overview of the purpose and key features of the regulatory accounts, and context to the framework for preparing them.

Purpose of regulatory financial statements and key policy issues

- 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. The accounts provide information in special-purpose financial statements. This information is more relevant for regulatory purposes than that contained in statutory accounts as the statements are set out in a format consistent with the relevant ORR policy and the financial framework established in the most recent periodic review of Network Rail's access charges. By contrast, statutory accounts are prepared in a format and follow rules prescribed by UK Generally Accepted Accounting Principles (GAAP), including accounting standards issued by the Accounting Standards Board, or where appropriate International Financial Reporting Standards.
- 1.8 The primary purposes of regulatory accounts can be summarised as follows:
- monitoring financial performance against the assumptions underlying ORR's Access Charges Review 2003 (ACR2003);

- informing future periodic 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 Regulatory Asset Base (RAB); and
- monitoring ongoing capital investment (particularly enhancements) made by the company in the rail network.

1.9 In developing these Guidelines, we have consulted with Network Rail and key funders of the railway and sought to minimise the regulatory burden on Network Rail. Network Rail is generally supportive of our revisions to these Guidelines. We expect to update the Guidelines further during the next periodic review of access charges. These updates are likely to reflect the way information is collected and analysed during the review. In particular, we are working with Network Rail to ensure that from 2006/07 onwards the regulatory accounts will provide more detail on maintenance, operations and operating costs.

Regulatory good practice

1.10 Other UK regulators require the companies they regulate to prepare annual regulatory accounts for similar reasons as those set out in paragraph 1.8. 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 (DTI) Green Paper on utility regulation, *A Fair Deal for Consumers*², 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. ORR was 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

² Available at <http://www.dti.gov.uk/urt/fairdeal/part1.htm>.

principles agreed by the working group. The main elements of these high-level principles are:

- regulatory accounts will be prepared and audited using the common regulatory accounting framework. Where there are any conflicts between Regulatory Accounting Guidelines (RAGs) and any other GAAP, then the RAGs 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.

1.12 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.

1.13 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

1.14 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. Network Rail's *Statement of the Adequacy of its Resources* covers a period looking forward 18 months from the date of signature of the regulatory accounts.

Basis of preparation

1.15 A key requirement of the regulatory accounts is that Network Rail's financial performance and position are reported on a consistent basis over time. The baseline for comparison is the ACR2003 determination.

1.16 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;
- cost allocation rules as set out in paragraphs 3.39 to 3.41, Annex B and Annex E of these Guidelines should be followed; and
- the valuation of the RAB in the regulatory accounts should be consistent with the basis adopted for the ACR2003 determination. The company's valuation of the RAB should be an estimation of the economic value of past investment (and other value included in the opening RAB) and activities that will be remunerated through allowed returns on the RAB in future years.

Auditors

1.17 Network Rail is required to obtain from its auditors (under paragraphs 9 and 10 of Condition 22) reports on:

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

1.18 The form of these reports has been established following discussion between ORR 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 ourselves. Paragraphs 2.14 to 2.17 provide further discussion of the auditors' role.

Delivery and publication – process

- 1.19 Condition 22 requires that Network Rail deliver to ORR all the regulatory accounts information, by 1 July following the end of the relevant financial year – or by a later date approved by us.
- 1.20 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.
- 1.21 If there was 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

- 1.22 The rest of this document covers the following areas:
- chapter 2 describes the content of the regulatory financial statements;
 - chapter 3 sets out ORR's policies relating to information required to be submitted in the regulatory accounts; and
 - the annexes to these Guidelines contain detailed information required to prepare the accounts such as templates for the regulatory financial statements and definitions of key terms.

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 22.

Regulatory financial statements

2.2 Paragraph 2 of Condition 22 requires Network Rail to prepare regulatory financial statements in relation to itself and also in relation to Network Rail Infrastructure Finance (NRIF)³.

2.3 Network Rail's regulatory financial statements should comprise the following elements:

- (a) a statement of regulatory financial performance;
- (b) a summary statement showing the opening RAB and additions or reductions to the RAB in the year (statement of regulatory financial position)⁴;
- (c) a more detailed statement showing additions to the RAB arising from investments in the year;
- (d) an expenditure statement;
- (e) an income statement; and
- (f) supporting notes that amplify and explain the statements where appropriate.

³ Network Rail Infrastructure Finance is the special purpose vehicle (SPV) that Network Rail has established to facilitate the licence holder's long-term debt issuance programme. Paragraph 13 of Condition 22 requires Network Rail to procure an undertaking from NRIF to enable Network Rail's obligations under paragraph 2 of Condition 22 to be performed.

⁴ This statement along with the statement of regulatory financial performance are referred to as "primary statements" for the purposes of Condition 22.

- 2.4 Appropriate audited financial statements procured by Network Rail from NRIF should also be provided.
- 2.5 From 2006/07, as well as the consolidated regulatory financial statements for Great Britain, the regulatory accounts should also include segmented regulatory financial statements for Scotland and England & Wales for each of the elements listed in paragraph 2.3 above. The requirement and approach to producing these segmented statements is discussed further in paragraphs 3.42 to 3.47.
- 2.6 The statement of regulatory financial performance is required by paragraph 3(c) of Condition 22 to compare income, expenditure, profits and losses for the period with the Determination Assumptions.
- 2.7 Templates, provided in Annex A to these Guidelines, should be followed. Presentation of the required information may be adapted following our agreement, provided it is analysed, aggregated and presented in a form that readily conveys the same information.
- 2.8 Appropriate narrative should also be included with the regulatory financial statements explaining the material variances from the previous year and from Determination Assumptions, and discussing other features of the year under review which Network Rail considers are relevant to an appreciation of its regulatory financial performance, financial position and future prospects. In previous years' regulatory accounts this information has included the following elements, which we would expect to be covered as a minimum in the regulatory accounts:
- a Directors' review, including analysis of financial performance in the year and highlighting any material variances from the Determination Assumptions;
 - a statement of the Directors' responsibilities; and
 - a statement of accounting policies.
- 2.9 Information on enhancements over and above that included in regulatory financial statement 3: *Analysis of capital expenditure (renewals and enhancements) for the RAB* (as referred to in paragraph 8 (d) of Condition 22) should follow the template attached as Annex C to these Guidelines.

- 2.10 Regional expenditure statements provided in previous years (also referred to as “Expenditure statements by Business Unit”) are no longer required as part of the regulatory accounts, but should instead be provided at the same time as part of Network Rail’s annual return submission for the relevant year (submitted under Condition 15 of Network Rail’s Network Licence)⁵.

Statement of adequacy of resources

- 2.11 Condition 12 of Network Rail’s Network Licence includes a requirement that the licence holder must, at all times, act in a manner calculated to secure that it has sufficient management resources, financial resources and financial facilities to enable it to carry on its activities and comply with its obligations under the Railways Act 1993 (as amended) and its Network Licence. In addition, under Condition 22, Network Rail is required to make a statement, approved by a resolution of the board of directors, certifying the adequacy of its resources for a period of 18 months. The form of this statement is prescribed in paragraph 5 of Condition 22 (see Annex D).
- 2.12 The statement should be submitted along with the auditors’ report at the same time as the regulatory financial statements, 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).
- 2.13 The purpose of this statement is to provide us and other interested parties with assurance on the future financial position of Network Rail.

Auditors’ reports and opinion

- 2.14 In common with statutory accounts, regulatory accounts are audited. The format for the audit of the regulatory financial statements will be set out in a terms of engagement letter which Network Rail is required to obtain under paragraph 11 of Condition 22. This audit opinion should identify material areas of judgement and any other material circumstances which appear to the auditors to be relevant with regard to these Guidelines and to the scope of work agreed with ORR.

⁵ As there is no requirement for these statements to be audited at present, ORR considers they should be included in the annual return. In future, we will required disaggregated statements supporting devolution (for example, for Scotland) to be audited.

- 2.15 Paragraph 9 of Condition 22 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 have been prepared in accordance with Condition 22 including these RAGs. The report should also state whether the information on enhancement expenditure produced in accordance with subparagraph (d) of paragraph 8 of Condition 22 has been prepared in accordance with the RAGs and is consistent with such expenditure presented in the primary financial statements.
- 2.16 Each statement made by Network Rail under paragraph 4 of Condition 22 (the statement on 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.
- 2.17 For 2005/06 the disaggregated regulatory financial statements will not be audited as part of the audit report on the 2005/06 regulatory financial statements but will be separately reviewed through an agreed upon procedures process.

Other statements/notes

- 2.18 Reconciliation with statutory accounts: a note should be included to show all details reasonably necessary to reconcile items included in the primary statements with any corresponding items in the accounts prepared under the Companies Act 1985 for the same period. In particular, the reconciliation should enable comparison of the movements in fixed assets on the company's balance sheet over the year with movements in the value of the RAB over the corresponding year.
- 2.19 Any other statements and supporting notes as required to present fairly the financial performance and financial position of the licence holder in accordance with Condition 22 and these Guidelines should be provided.

3. Policies

Introduction

- 3.1 A key objective of these Guidelines is to establish regulatory accounts that are fully consistent with the financial framework established by the ACR2003. The key elements of this financial framework that are relevant to the regulatory accounts, and resulting regulatory accounting policies, are set out in the remainder of this chapter.

Background

- 3.2 The ACR2003 established the regulatory framework under which Network Rail would operate for the five years between April 2004 and March 2009, 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 should receive in income is calculated as the sum of forecast expenditure on operating and maintaining the network, plus an allowance for amortisation of investment and an overall return, less other income received through the single till.
- 3.4 This methodology differs from that adopted in our Periodic Review 2000 (PR2000) in one important respect. Whereas expenditure on renewals was previously funded pound-for-pound in the year that the expenditure was to be incurred, Network Rail will finance a proportion of new investment in the renewal and improvement of the network through borrowing. This move to capitalisation of renewals spend has implications for the future determinations of the valuation of the RAB, and future additions to the RAB because at the end of one control period there will be a balance included in the RAB (i.e. gross efficient investment expenditure less depreciation) which will be amortised over future control periods.

Indexation

- 3.5 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 (RPI) published by the Office for National Statistics (ONS) and based on the index RPI CHAW, available from the ONS website⁶.
- 3.6 Using the RPI CHAW index, for the year 2005-06 to convert to 2005-06 prices, indexation of 8.642% should be applied to all figures expressed in 2002-03 prices, indexation of 5.966% should be applied to all figures expressed in 2003-04 prices and indexation of 2.434% should be applied to all figures expressed in 2004-05 prices.

Capitalisation of renewals

- 3.7 A key purpose of the regulatory accounts is to monitor the RAB during the control period, using the methodology adopted for the PR2000 expensed renewals expenditure. Therefore, only a limited number of additions would be expected to be added to the RAB. These would be the result of various designated enhancements, plus any additions as a result of regulatory incentive mechanisms (i.e. broken rails incentive and volume incentive).
- 3.8 However, under the ACR2003 methodology, forecast expenditure incurred in renewing and enhancing the network is added to the RAB for the period 1 April 2004 to 31 March 2009 and remunerated through the allowance for amortisation. This has important implications for how renewals expenditure is recorded in the regulatory accounts.
- 3.9 Broadly speaking, the ACR2003 established a fixed-price, fixed output framework. This means that we set a revenue allowance based on the expenditure that an efficient company would incur in delivering the specified baseline outputs. Under this approach, generally deviations from the expenditure allowance are retained/borne by the company as out/under-performance, provided Network Rail has delivered the required outputs. This approach is used widely in other regulated industries and represents a key feature of the incentive framework established by the ACR2003.

⁶ See <http://www.statistics.gov.uk/STATBASE/tsdataset.asp?vlnk=229&More=Y>.

- 3.10 In order to maintain this incentive, the value of the RAB in the regulatory accounts for the period to 31 March 2009 is set using the renewals expenditure forecasts contained within the ACR2003 determination and not with reference to the actual renewals expenditure incurred by Network Rail. Actual expenditure should be recorded separately in the regulatory accounts to enable performance against the determination to be monitored. An appropriate adjustment for actual expenditure will be made as part of CP4 and reflected in regulatory accounts from 2009/10 onwards.

Amortisation allowances

- 3.11 As discussed earlier in this document, the ACR2003 introduced a new approach to the remuneration of capital expenditure, moving from the original pay-as-you-go approach to the more standard capitalisation approach used widely in other regulated utilities. Under this approach renewals and enhancement expenditure is added to the RAB, with an offsetting 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.
- 3.12 The amortisation revenues allowed in the regulatory settlement comprise two parts: amortisation of the opening RAB and amortisation of capital expenditure incurred after 31 March 2004. A full discussion of our amortisation rules is contained within the ACR2003 final conclusions (chapter 12)⁷. The key points regarding the structure of the remuneration and the recording of the revenue are discussed below (see the template regulatory financial statement 2 in Annex A for more details).

Amortisation of existing RAB

- 3.13 The amortisation of the existing RAB (as at 1 April 2004) remunerates Network Rail for spend incurred before 1 April 2004. We explained in the ACR2003 that the amortisation of the existing RAB would be on a reducing balance basis (at 7% per annum).
- 3.14 The regulatory accounts will therefore need to monitor the value of the existing RAB on an ongoing basis. The reductions in the RAB as a result of

⁷ *Access Charges Review 2003: final conclusions*, Office of Rail Regulation, London, December 2003.

amortisation for the five years to 31 March 2009 were stated in the ACR2003 final conclusions.

Amortisation of capital expenditure incurred after 31 March 2004

- 3.15 Expenditure on renewals and enhancements will be amortised on a straight-line basis. The ACR2003 determined that all investment expenditure incurred after 31 March 2004 will be amortised over a common period (30 years), representing an average asset life.
- 3.16 The calculation of the RAB for the period to 31 March 2009 is given by subtracting the total forecast amortisation for the year (as stated in the ACR2003 final conclusions) from the opening RAB for the year, plus forecast renewals and forecast enhancements expenditure and an appropriate adjustment for inflation (see the section on inflation), as well as any other adjustments as set out in the regulatory financial statements template.

Incentive mechanisms

- 3.17 The ACR2003 determination contained a number of financial incentives to incentivise efficiency and good performance by Network Rail. A number of these incentives reward Network Rail for outperformance through adjustments to revenue, such as payments received through Schedules 4 and 8 of the track access agreements. Any revenues/payments resulting from these incentives will need to be recorded in the regulatory accounts income statement.
- 3.18 The ACR2003 also included two incentive mechanisms that would reward Network Rail through a consolidated increase in the RAB. The structure and objective of these incentives (the volume incentive and the asset stewardship incentive) are described in detail in chapter 19 of the ACR2003 final conclusions.
- 3.19 Any reward payable to Network Rail under these incentives, and therefore any resulting adjustment to the RAB, will be made at the next periodic review (scheduled to take effect in April 2009). On a year-by-year basis, the regulatory accounts will therefore monitor Network Rail's performance against these incentive measures. The financial effect of the performance in each country will be logged up on a year-by-year basis in the relevant RAB

statement, with no actual or projected adjustments made to the RAB until the end of the control period.

- 3.20 The volume incentive and the asset stewardship incentive index will be disaggregated to form separate measures for Scotland and England and Wales.

Capitalised financing

3.21 Under UK GAAP, assets should be initially measured at cost, where cost is the purchase price plus any costs directly attributable to bringing the asset into working condition. It is an option to include the capitalisation of finance costs in the cost of the asset (i.e. in the balance sheet), with any capitalisation commencing when finance costs are being incurred and ceasing when the asset enters use.

3.22 Capitalisation of financing costs should therefore only be applied to certain items of expenditure incurred by Network Rail that were not funded by the ACR2003 final conclusions. The only categories of expenditure recorded in the regulatory accounts that may include an allowance for capitalised finance are therefore:

- investments not funded through the ACR2003, but approved by us for addition to the RAB;
- the variance on emerging cost enhancements (see paragraph 3.28 below); and
- any items relating to other unfunded expenditure adjustments agreed with us (e.g. signalling/possessions reviews and cost of meeting additional obligations).

3.23 For the purposes of calculating appropriate RAB additions in the regulatory accounts in a transparent manner, any additional 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 the final conclusions of ACR2003, i.e. 6.75% in 2004-05 and 2005-06 and 6.29% thereafter⁸.

⁸ These return figures represent a mid-year rate of return as opposed to the annual average returns allowed in the ACR2003 of 7% and 6.5%.

- 3.24 For the designated categories shown in paragraph 3.22, capitalised financing should therefore be applied using the following formula (where 0.5 reflects the assumption of mid-year spend and RoR represents the appropriate allowed rate of return i.e. either 6.75% or 6.29%):

$$\text{capitalised finance} = \text{expenditure in year} \times 0.5 \times \text{RoR}$$

- 3.25 As described above, the RAB additions for renewals and enhancements expenditure funded through the ACR2003, to be shown in the regulatory accounts for 2004-05 to 2008-09, will simply be the level of spend assumed in the ACR2003 final conclusions regardless of any variances compared to actual expenditure. As described above, the amortisation and financing costs resulting from any deviation from these levels in 2004-05 to 2008-09 is generally assumed to be retained/borne by the company as out/under-performance and it would therefore be inappropriate to reduce the incentive effects by allowing for capitalised financing on any such expenditure.

Treatment of expenditure on investment incurred after 31 March 2004

General principles

- 3.26 In October 2005 we published a document setting out our policy conclusions on the framework for investments⁹. This framework is necessary to deal with unforeseen investments that may arise between periodic reviews (or be required by third parties outside the periodic review framework) and clarity is therefore required on the treatment of these new schemes, particularly their funding.
- 3.27 The regulatory accounts provide the mechanism for monitoring, recording and reporting investment expenditure during the control period through the regulatory financial statements. In the revised regulatory financial statements investment expenditure should be recorded and added to the RAB in two broad categories: investments already funded in the ACR2003 and investment expenditure not funded in the ACR2003.

⁹ *Policy framework for investments: Conclusions*, Office of Rail Regulation, London, October 2005. <http://www.rail-reg.gov.uk/upload/pdf/255.pdf>

Investments funded in ACR2003

- 3.28 The ACR2003 final conclusions established an allowance for investment expenditure relating to work Network Rail is required to carry out during the control period. Almost all schemes were included on a fixed price basis, as noted above. The determination expenditure on these schemes should be recorded as a line item in the regulatory accounts and will usually be added to the RAB, subject to the required outputs being delivered. Similar to the treatment of renewals, the amortisation and financing costs resulting from any deviation from the expenditure allowance is generally retained/borne by the company as out/under-performance¹⁰.
- 3.29 In the event that an investment funded through the periodic review is not required by the relevant customer or funder, Network Rail is required to notify ORR and the relevant reduction in expenditure should be logged up in the regulatory accounts, with the RAB reduced by the appropriate amount in 2009, taking into account any revenue Network Rail had already received for the scheme through a return on the RAB or amortisation.
- 3.30 Where it is necessary to amend the profile of works and spend on a scheme, we would not expect to make any changes to the RAB addition set in the ACR2003, providing that the same outputs are still to be delivered within the control period. Details of the outputs delivered and spend on individual schemes are provided as part of the annual reporting on investments (see paragraph 3.38).

Investments not funded by the ACR2003

- 3.31 In the course of a five-year control period there may be some investment schemes that will be required but which were not foreseen at the time of the last periodic review. 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. Efficient expenditure on all such schemes should be logged up by Network Rail for inclusion in the RAB, subject to the criteria set out in the next section. As

¹⁰ The exception to this rule is certain time-critical "transition projects" (such as Southern Region New Trains Programme) sponsored by the Strategic Rail Authority (SRA), which are treated on an emerging cost basis such that any over- or underspend is added to the RAB automatically in 2009, based on the actual costs logged up in the regulatory accounts, including any appropriate adjustments for financing costs.

these schemes are unforeseen, Network Rail is allowed to log up capitalised financing on its efficient costs.

3.32 Our October 2005 policy conclusions on the investment framework document explains how we will treat different types of investment scheme. The key categories are:

- schemes within the proposed Network Rail discretionary fund;
- Government-sponsored schemes;
- Network Rail-promoted schemes; and
- schemes promoted by third parties.

3.33 Our October 2005 document on investments also described the criteria that we will apply when considering whether or not to make an addition to the RAB in respect of investment expenditure. In summary, we will need to be satisfied that:

- the expenditure has been incurred as a result of a reasonable requirement of Government (i.e. Department of Transport (DfT) or Transport Scotland as appropriate), and that Government supports the financial commitment arising;
- the outputs required by the scheme promoter or customer have been delivered;
- the expenditure has been efficiently incurred; and
- the expenditure adds to the economic value of Network Rail's business (or, potentially, to the rail network as a whole).

3.34 More detail on these criteria is also given in our March 2006 Investment guidelines document¹¹.

Process for adding investment expenditure to the RAB

3.35 We expect to make additions to the RAB provided the criteria set out in the last paragraph are satisfied. These criteria can be satisfied through the

¹¹ Available at <http://www.rail-reg.gov.uk/upload/pdf/277.pdf>.

provision of appropriate information from the delivery agent (Network Rail in the case of schemes funded through the RAB) and the scheme's customers or funders. Network Rail and/or customers/funders should in general submit the following information on each scheme for which a RAB addition is sought:

- agreed outputs for the scheme to deliver, with estimated delivery dates;
- the agreed price for delivering the scheme outputs;
- the amount and timing of an agreed RAB addition that the funder is prepared to support, allowing for any financing costs;
- details of any other agreed method of remunerating the outputs;
- the governance arrangements for the scheme, including risk allocation between the parties and remedies in the case of non, or partial, delivery;
- if appropriate, the contingency for unidentified or unquantifiable risks; and
- calculations showing any non-RAB revenues to remunerate Network Rail for the investment and the expected RAB addition.

3.36 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 capital expenditure (renewals and enhancements) for the RAB* of the regulatory financial statements. Provided we are satisfied that all required assurances and information has been provided (we will check that the draft regulatory financial statements record all enhancement expenditure incurred in accordance with the criteria and processes set out in our policy framework for investments), the relevant amount will enter the RAB at the agreed time, along with any financing costs.

3.37 Similar information on individual schemes put forward for addition to the RAB is also required in the regulatory accounts for monitoring purposes, and this information is set out in the following paragraph.

Reporting of investments

3.38 Statement 2: *RAB adjustments and accruals* of the regulatory financial statements presents expenditure on all investment schemes for which

Network Rail is seeking an increase to the RAB. The information required on each scheme for which expenditure is put forward for addition to the RAB is set out in Annex C: *Enhancement reporting template*. A more detailed schedule of investment schemes is also submitted to us at the same time as the regulatory accounts. In this detailed schedule, Network Rail is required to record details of each investment project for which it is seeking an increase to the RAB, to provide information for:

- summarising the agreed terms for each scheme, as agreed between Network Rail and the customer(s) and funder(s);
- monitoring scheme expenditure and progress annually; and
- recording delivery of investments.

Cost allocation rules

3.39 Network Rail is required for 2005/06 to attribute its total annual expenditure to four main headings: renewals, maintenance, operating expenditure and enhancements. We are working with Network Rail to ensure that from 2006/07 onwards the regulatory accounts will provide more detail on maintenance, operations and operating costs. Therefore, for 2006/07 onwards, Network Rail will be required to attribute its total annual expenditure to five main headings: renewals, maintenance, operations, operating expenditure and enhancements.

3.40 As a general principle, the detailed cost attribution and allocation policies that Network Rail adopts should not change from year to year. In particular, 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 the policies it used when preparing its 2002-03 regulatory accounts. In addition:

- costs should be allocated in relation to the way resources are consumed;
- direct costs should be allocated in the way in which they are incurred;
- indirect costs should be allocated objectively using a reasonable methodology having regard to the materiality of the allocations; and

- general costs should be allocated to the appropriate heading to which they relate, in line with the way in which resources have been consumed.

3.41 More detail on cost allocation rules is given in Annex B (particularly relating to definitions).

Disaggregation of the Regulatory Financial Statements

Background

3.42 In July 2004, the DfT published The Future of Rail White Paper. A major area of change introduced by the White Paper is the devolution of greater powers and responsibilities for specifying high-level railway outputs and funding rail services to devolved administrations. In particular, from 1 April 2006, Scottish Ministers will have responsibility for specifying and funding the network infrastructure in Scotland.

3.43 Following a consultation process, in December 2005 we published a document¹² setting out details of our approach to regulation of the railways in Scotland in response to the new arrangements introduced by the White Paper. One important change to the regulatory framework is that at future access charge reviews, Network Rail's price control will be separated so that we will establish the company's outputs and corresponding revenue requirement separately for Scotland and for England & Wales.

3.44 We are also introducing a greater level of transparency and accountability to the price control arrangements for the remainder of the current control period 3 (CP3). This will ensure a greater level of monitoring of Network Rail's performance and financial position for England & Wales and Scotland separately as well as Great Britain as a whole. In practice, this means that from 2006/07 Network Rail's regulatory financial statements will report separate disaggregated information on the company's financial performance in Scotland and in England & Wales as well as in Great Britain as a whole.

Allocation of costs and revenues

3.45 A high proportion of Network Rail's expenditure on operating, maintaining, renewing and enhancing the network is directly attributable to specific

¹² ORR's approach to regulation in Scotland: Conclusions, Office of Rail Regulation, December 2005: <http://www.rail-reg.gov.uk/upload/pdf/267.pdf>

geographic areas, including Scotland. However, some of the company's costs are incurred centrally (e.g. Information Systems costs and Human Resources costs) and it has, therefore, been necessary to establish rules for the allocation of an appropriate share of Network Rail's central costs that are not directly allocated to any geographic area.

- 3.46 A considerable amount of work on allocation of centrally incurred (or common) costs was undertaken by Transport Scotland's consultants during the latter part of 2004 to inform the calculation of the funding settlement that would be necessary between the Secretary of State for Transport and Scottish Ministers as part of the new arrangements. We have subsequently reviewed these cost and revenue allocation rules and discussed them with Network Rail. We consider these metrics to be an appropriate basis to allocate common costs and have used them to establish an indicative disaggregation of Network Rail's revenue requirement for the remainder of the current control period¹³.
- 3.47 These metrics will now be used by Network Rail to allocate common costs and revenues for the remainder of the current control period. Details of each of the relevant metrics and the percentage to be applied to Scotland and to England & Wales are set out in Annex E.

The Regulatory Asset Base

- 3.48 Under the price control separation arrangements that we are implementing, it will be necessary for Network Rail to report separately on adjustments and accruals to the element of the RAB allocated to Scotland and the element of the RAB allocated to England & Wales.
- 3.49 We set out details of our approach to separating the RAB in our June consultation document on disaggregation issues¹⁴. Our chosen methodology for disaggregating the RAB is a composite approach that considers the effect of both the underlying value of the assets and the level of use of these assets.

¹³ Details of the disaggregated revenue requirements for Scotland and England & Wales are set out in Annex B of our December 2005 document on the approach to regulation in Scotland.

¹⁴ Disaggregating Network Rail's expenditure and revenue allowance and the future price control framework: a consultation, Office of Rail Regulation, June 2005: <http://www.rail-reg.gov.uk/upload/pdf/238.pdf>

Using that methodology, we calculated that the appropriate proportion of the RAB to be allocated to Scotland is 11.17%.

- 3.50 Under the devolution arrangements introduced by the White Paper, Transport Scotland has taken on responsibility for funding the railways in Scotland since 1 April 2006. Therefore, from that date Network Rail's RAB was separated on the basis that 11.17% of the GB total is allocated to Scotland, with the rest allocated to England & Wales¹⁵. Network Rail will report separately on adjustments for capital expenditure and amortisation and other accruals to the element of the RAB allocated to Scotland and the element of the RAB allocated to England & Wales.

Summary

- 3.51 Taken together these changes mean that from the financial year 2006/07, Network Rail will be required to produce additional regulatory financial statements to those described in para 2.3 above, specifically the company will be required to produce separately for Scotland and for England & Wales as well as for Great Britain as a whole:
- (a) a statement of regulatory financial performance;
 - (b) a summary statement showing the opening RAB and additions or reductions to the RAB in the year (statement of regulatory financial position);
 - (c) a more detailed statement showing additions to the RAB arising from investments in the year;
 - (d) an expenditure statement;
 - (e) an income statement; and
 - (f) supporting notes that amplify and explain the statements where appropriate.

¹⁵ Under the funding settlement agreed between the Scottish Executive and the DfT, all of the ACR2003 funded enhancements are attributable to the 'England & Wales' RAB. This includes enhancement expenditure incurred in 2004-05 and 2005-06. Therefore, in practice, the opening RAB split for Scotland will be based on 11.17% of the GB RAB at April 2006 less enhancements expenditure in the first two years of the control period. This expenditure will be added to the England and Wales RAB.

3.52 Templates for each of the additional statements are set out in Annex A.

Annex A: Required statements and disclosures and Determination Assumptions

Statements

Primary statements:

- 1: Regulatory financial performance
- 2: RAB adjustments and accruals (regulatory financial position)

Other statements:

- 3: Analysis of capital expenditure (renewals and enhancements) for the RAB
- 4: Analysis of O, M & R expenditure
- 5: Analysis of Income

Including:

- Supporting notes as appropriate; and
- Accounts prepared under the Companies Act 1985 (including relevant statements procured from NRIF).

Other required disclosures:

- reconciliation with statutory accounts;
- statement of adequacy of management and financial resources;
- statement under licence condition 29;
- auditors' reports; and
- other (see paragraph 2.19).

Note:

We are working with Network Rail to ensure that from 2006/07 onwards the regulatory accounts will provide more detail on maintenance, operations and operating costs. Therefore, for 2006/07 onwards the Analysis of O, M and R template will be revised to provide more detail on those costs.

Template regulatory financial statements

NB: Figures given in the template regulatory financial statements relating to actual performance are indicative only, and any variances shown against the Determination Assumptions are purely for illustrative purposes.

Statement 1:GB Regulatory Financial Performance
in £m 2005/06 prices

2003 Access Charges Review Final Conclusions:

	2004/05	2005/06	2006/07	2007/08	2008/09	Cumulative
Operating expenditure						
Maintenance expenditure						
Schedule 4 (income)/costs						
Schedule 8 (income)/costs						
Return on RAB (as per ACR2003)						
Amortisation						
Gross revenue						
Other income						
Net Revenue						
Variable charge income incl Sch 4 & 8 charges						
Total net revenue recovered through fixed TACs/grants						
Split of Grants/Track access charges as per ORR 10 March 2004 Statement						
Variable charges						
Fixed charges						
Total TACs						
Grants						
Deferred grants						
Total revenue						
Total revenue received in year						
Reconciliation to total income						
Other income						
Schedule 4						
Schedule 8						

Actual Performance	2004/05	2005/06	2006/07	2007/08	2008/09	Total
Operating expenditure						
Maintenance						
Schedule 4 (income)/costs						
Schedule 8 (income)/costs						
Return on RAB						
Amortisation						
Gross revenue						
Other income						
Net Revenue						
Variable charge income incl Sch 4 & 8 charges						
Total net revenue recovered through fixed TACs/grants						
Split of Grants/Track access charges						
Variable charges						
Fixed charges (net of £250m rebate)						
Total TACs						
Grants						
Deferred grants						
Total revenue						
Total revenue received in year						
Rebates						
Net revenue received in year						
Reconciliation to total income						
Other income						
Schedule 4						
Schedule 8						
Total income (see statement 5)						

	2004/05	2005/06	2006/07	2007/08	2008/09	Total
<u>Difference between ORR determination and actual:</u>						
Operating expenditure						
Maintenance						
Schedule 4 (income)/costs						
Schedule 8 (income)/costs						
Return on RAB						
Amortisation						
Gross revenue						
Other income						
Net Revenue						
Variable charge income incl Sch 4 & 8 charges						
Total net revenue recovered through fixed TACs/grants						
Split of Grants/Track access charges						
Variable charges						
Fixed charges						
Total TACs						
Grants						
Deferred grants						
Total revenue						
Total revenue received in year						
Rebates						

Statement 2: GB RAB adjustments and accruals (Regulatory financial position)

Figures in £m 05/06 prices unless stated
Calculation of RAB

Movements in the year 2005/06	
Opening value	£m
Adjustment	£m
Capitalised financing (return)	£m
Total as at 31/3/06	£m

Opening RAB for the year (04/05 prices)

Amortisation of April '04 RAB

Opening April '04 RAB (05/06 prices)

Amortisation on April '04 RAB (7% reducing balance)

Opening RAB after amortisation

Renewals and Enhancements (see Statement 3 for more detail)

Renewals

Enhancements in ACR2003

Amortisation on post April '04 investment (3.33% straight line)

Variance on emerging cost enhancements

Investments not funded in ACR2003

Net addition to the RAB from renewals and enhancements

Other adjustments to be incorporated in April 2006 RAB*

Closing RAB

Debt

Debt/RAB ratio

* Other adjustments to the RAB (such as cost of meeting additional obligations) to be shown in a separate note

Annual Adjustments

Analysis of value by year of movement, current prices

Value at 1 April	2004	Adjustment in	2004/05	Adjustment in	2005/06	Adjustment in	2006/07	Adjustment in	2007/08	Adjustment in	2008/09	Total adjustments for regulatory incentive mechanisms	Total
£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m

Opening RAB for the year

Adjustment to reflect 2003/04 underspend and net debt
 Difference between actual 03/04 outturn and ACR determination
 Adjustment for net debt levels
 Adjusted Opening RAB

Amortisation on existing RAB
 Amortisation on existing RAB (7% reducing balance)
Adjusted Opening RAB after amortisation

Renewals and Enhancements (see Statement 3 for more detail)
 Renewals
 Enhancements in ACR2003
 Variance on emerging cost enhancements
 Investments not funded in ACR2003
 Amortisation on post April '04 investment (3.33% straight line)
 Net addition to the RAB from renewals and enhancements

Other adjustments
Adjustment to be incorporated in 2009 RAB
 Closing RAB for year

Indicative Adjustments to 2009 RAB for incentive mechanisms (not to be included until end of CP)
 Asset stewardship incentive
 Volume incentive

1 April 2009 RAB

*** Detailed note for other adjustments**

Other adjustments to be incorporated in April 2006 RAB (where relevant)
 Adjustment to reflect signalling review
 Adjustment to reflect possessions review
 Land disposal compensation
 Cost of meeting additional obligations
 Investments not approved by ORR
 Railway safety charge (difference)

Other adjustments to be incorporated in April 2006 RAB

Statement 3: GB Analysis of capital expenditure (renewals and enhancements) for the RAB

Figures in £m 05/06 prices unless stated

	Spend in the year		
	Actual £m	ACR2003 RAB £m	Difference £m
Renewals included in the ACR2003			
Total renewals			
Enhancements included in the ACR2003			
Health & Safety schemes			
Train protection schemes			
LMD Pollution Prevention			
Other S&E Plan schemes			
Total Health & Safety			
Emerging cost enhancements (transition schemes)			
Southern Power Upgrade			
SRNTP (non-PSU)			
CTRL Blockade			
Thameslink 2000 development			
Total emerging cost schemes			
Telecoms enhancements			
WCRM enhancements			
Total enhancements in ACR03			
Investments not included in the ACR2003			
Government-sponsored schemes			
SRNTP: non-PSU works			
Others			
Total Government-sponsored schemes			
Network Rail-promoted schemes			
Schemes in DfT pot for discretionary spend*			
Tyseley South			
Peterborough-Werrington			
Other schemes (approved separately)			
Total NR-promoted schemes			
Schemes promoted by third parties			
Project Evergreen 2			
Others			
Total schemes promoted by third parties			
Other enhancement projects			
Total new investments			
Total renewals and enhancements			

* Separate note required showing breakdown between schemes and outputs

Statement 4:GB Analysis of O, M & R expenditure

Figures in £m 05/06 prices unless stated

	Spend in the year		
	Actual	ACR2003	Difference
	£m	£m	£m
Renewals			
Non-WCRM			
Track			
Structures			
Signalling			
Telecoms			
Electrification			
Plant and machinery			
Operational property			
Other (incl IT)			
Total non-WCRM			
Total WCRM renewals			
Total renewals			
Total Maintenance*			
Operating expenditure			
Controllable operating expenditure**			
Uncontrollable operating expenditure			
Total operating expenditure			
Total O, M & R			

* For the 05/06 regulatory accounts maintenance expenditure will be reported by asset category (or other appropriate activity breakdown).

** Including £.xx million for staff costs and £.yy million on production and management costs.

Statement 5: GB Analysis of Income*Figures in £m 05/06 prices unless stated*

	Receipts in the year		
	Actual £m	ACR2003 £m	Difference £m
Franchised Track Access Income			
Fixed charge			
Usage charge			
Capacity charge			
EC4T			
Schedule 4 net income			
Schedule 8 net income			
Other contractual receipts			
Total Franchised Access Income			
Grant Income			
Total income from TACs and grants			
Other single till income			
Property income			
Freight income			
Open access income			
Stations income			
Depots income			
Third party funded enhancement schemes			
Other			
Total other single till income			
Total income			
Freight income			
Variable track access			
Capacity charge			
Performance regime			
Cancellations			
EC4T			
Other			
Total freight income			

Statement 1: Scotland Regulatory Financial Performance
in £m 2005/06 prices

	Spend in the year		
	Actual	Indicative determination	Difference
Operating expenditure			
Maintenance expenditure			
Schedule 4 (income)/costs			
Schedule 8 (income)/costs			
Return on RAB			
Amortisation			
Gross revenue			
Other income			
Net Revenue			
Variable charge income incl Sch 4 & 8 charges			
Total net revenue recovered through fixed TACs/grants			
<hr/>			
Split of Grants/Track access charges			
Variable charges			
Fixed charges			
Total TACs			
<hr/>			
Grants			
Deferred grants			
Total revenue			

Note:

The format shown above is for the first year of separate price controls. In subsequent years cumulative numbers will be shown in the same format as GB statement 1.

Statement 2: Scotland RAB adjustments and accruals (Regulatory financial position)

Figures in £m 06/07 prices unless stated
Calculation of RAB

Movements in the year 2006/07			
Opening value	Adjustment	Capitalised financing (return)	Total as at 31/3/07
£m	£m	£m	£m
Amortisation of April '04 RAB			
Opening RAB for the year (05/06 prices)			
Opening April '04 RAB (06/07 prices)			
Amortisation on April '04 RAB (7% reducing balance)			
Opening RAB after amortisation			
Adjustments for actual 03/04 net debt			
Adjustment for net debt levels			
RAB after adjustments for 03/04 figures			
Renewals and Enhancements (see Statement 3 for more detail)			
Renewals			
Enhancements in ACR2003			
Amortisation on post April '04 investment in ACR2003 (3.33% straight line)			
Variance on emerging cost enhancements			
Investments not funded in ACR2003			
Net addition to the RAB from renewals and enhancements			
Other adjustments to be incorporated in April 2007 RAB*			
Closing RAB			
Notional debt **			
Notional debt to RAB ratio **			

* Other adjustments to the RAB (such as cost of meeting additional obligations) to be shown in a separate note
 ** Not required to be published

	£m	2004	Adjustment in 2004/05	Adjustment in 2005/06	Adjustment in 2006/07	Adjustment in 2007/08	Adjustment in 2008/09	£m	Total adjustments for regulatory incentive mechanisms	£m	Total
Annual Adjustments											
Opening RAB for the year (05/06 prices)											
Adjustment to reflect 2003/04 net debt											
Adjustment for net debt levels											
Adjusted Opening RAB											
Amortisation on existing RAB											
Amortisation on existing RAB (7% reducing balance)											
Adjusted Opening RAB after amortisation											
Renewals and Enhancements (see Statement 3 for more detail)											
Renewals											
Enhancements in ACR2003											
Amortisation on post-April 04 investment in ACR2003 (3.33% straight line)											
Variance on emerging cost enhancements											
Investments not funded in ACR2003											
Net addition to the RAB from renewals and enhancements											
Other adjustments											
Adjustment to be incorporated in 2009 RAB											
Closing RAB for year											
Indicative Adjustments to 2009 RAB for incentive mechanisms (not to be included until end of CP)											
Asset stewardship incentive											
Volume incentive											
1 April 2009 RAB											
Note: As the separate price controls for Scotland and England & Wales started on 1 April 2006, this statement is for 2006/07.											
* Detailed note for other adjustments											
Other adjustments to be incorporated in April 2007 RAB (where relevant)											
Adjustment to reflect signalling review											
Adjustment to reflect possessions review											
Land disposal compensation											
Cost of meeting additional obligations											
Investments not approved by ORR											
Railway safety charge (difference)											
Other adjustments to be incorporated in April 2007 RAB											

Regulatory Accounting Guidelines

Statement 3: Scotland Analysis of capital expenditure (renewals and enhancements) for the RAB

Figures in £m 05/06 prices unless stated

	Spend in the year		
	Actual	Indicative	Difference
	£m	determination £m	£m
Renewals included in the ACR2003			
Total renewals			
Enhancements included in the ACR2003			
Health & Safety schemes			
Scheme 1			
Scheme 2			
Scheme 3			
Total Health & Safety			
<i>Emerging cost enhancements (transition schemes)</i>			
Scheme 1			
Scheme 2			
Scheme 3			
Scheme 4			
<i>Total emerging cost schemes</i>			
Telecoms enhancements			
WCRM enhancements			
Total enhancements in ACR03			
Investments not included in the ACR2003			
Government-sponsored schemes			
Scheme 1			
Scheme 2			
<i>Total Government-sponsored schemes</i>			
Network-Rail promoted schemes			
Scheme 1			
Scheme 2			
Scheme 3			
Scheme 4			
<i>Total NR-promoted schemes</i>			
Schemes promoted by third parties			
Scheme 1			
Scheme 2			
<i>Total schemes promoted by third parties</i>			
Other enhancement projects			
Total new investments			
Total renewals and enhancements			

* Separate note required showing breakdown between schemes and outputs

Statement 4: Scotland Analysis of O, M & R expenditure

Figures in £m 05/06 prices unless stated

	Spend in the year		
	Actual £m	Indicative determination £m	Difference £m
Renewals			
Non-WCRM			
Track			
Structures			
Signalling			
Telecoms			
Electrification			
Plant and machinery			
Operational property			
Other (incl IT)			
Total non-WCRM			
Total WCRM renewals			
Total renewals			
Total Maintenance*			
Operating expenditure			
Controllable operating expenditure**			
Uncontrollable operating expenditure			
Total operating expenditure			
Total O, M & R			

* For the 05/06 regulatory accounts maintenance expenditure will be reported by asset category (or other appropriate activity breakdown).

** Including £xx million for staff costs and £yy million on production and management costs.

Statement 5: Scotland Analysis of Income

Figures in £m 05/06 prices unless stated

	Receipts in the year		
	Actual	Indicative	Difference
	£m	£m	£m
Franchised Track Access Income			
Fixed charge			
Usage charge			
Capacity charge			
EC4T			
Schedule 4 net payments			
Schedule 8 net payments			
Other contractual receipts			
Total Franchised Access Income			
Grant Income			
Total income from TACs and grants			
Other single till income			
Property income			
Freight income			
Open access income			
Stations income			
Depots income			
Third party funded enhancement schemes			
Other			
Total other single till income			
Total income			
Freight income			
Variable track access			
Capacity charge			
Performance regime			
Cancellations			
EC4T			
Other			
Total freight income			

Statement 1: England & Wales Regulatory Financial Performance
in £m 2005/06 prices

	Spend in the year		
	Actual	Indicative determination	Difference
Operating expenditure			
Maintenance expenditure			
Schedule 4 (income)/costs			
Schedule 8 (income)/costs			
Return on RAB			
Amortisation			
Gross revenue			
Other income			
Net Revenue			
Variable charge income incl Sch 4 & 8 charges			
Total net revenue recovered through fixed TACs/grants			
<hr/>			
Split of Grants/Track access charges			
Variable charges			
Fixed charges			
Total TACs			
<hr/>			
Grants			
Deferred grants			
Total revenue			

Note:

The format shown above is for the first year of separate price controls. In subsequent years cumulative numbers will be shown in the same format as GB statement 1.

Statement 2: England & Wales RAB adjustments and accruals (Regulatory financial position)

Figures in £m 06/07 prices unless stated
Calculation of RAB

Movements in the year 2006/07				
	Opening value £m	Adjustment £m	Capitalised financing (return) £m	Total as at 31/3/07 £m
Amortisation of April '04 RAB				
Opening RAB for the year (05/06 prices)				
Opening April 04 RAB (06/07 prices)				
Amortisation on April 04 RAB (7% reducing balance)				
Opening RAB after amortisation				
Adjustments for actual 03/04 net debt				
Adjustment for net debt levels				
RAB after adjustments for 03/04 figures				
Renewals and Enhancements (see Statement 3 for more detail)				
Renewals				
Enhancements in ACR2003				
Amortisation on post April 04 investment in ACR2003 (3.33% straight line)				
Variance on emerging cost enhancements				
Investments not funded in ACR2003				
Net addition to the RAB from renewals and enhancements				
Other adjustments to be incorporated in April 2007 RAB*				
Closing RAB				
Notional Debt **				
Notional Debt to RAB ratio **				

* Other adjustments to the RAB (such as cost of meeting additional obligations) to be shown in a separate note
 ** Not required to be published

Annual Adjustments

	Value at 1 April 2004	Adjustment in 2004/05	Adjustment in 2005/06	Adjustment in 2006/07	Adjustment in 2007/08	Adjustment in 2008/09	Total adjustments for regulatory incentive mechanisms	Total
	£m	£m	£m	£m	£m	£m	£m	£m
<i>Analysis of value by year of movement, current prices</i>								
Opening RAB for the year								
Adjustment to reflect 2003/04 net debt								
Adjustment for net debt levels								
Adjusted Opening RAB								
Amortisation on existing RAB								
Amortisation on existing RAB (7% reducing balance)								
Adjusted Opening RAB after amortisation								
Renewals and Enhancements (see Statement 3 for more detail)								
Renewals								
Enhancements in ACR2003								
Amortisation on post April 04 investment in ACR2003 (3.33% straight line)								
Variance on emerging cost enhancements								
Investments not funded in ACR2003								
Net addition to the RAB from renewals and enhancements								
Other adjustments								
Adjustment to be incorporated in 2009 RAB								
Closing RAB for year								
Indicative Adjustments to 2009 RAB for incentive mechanisms (not to be included until end of CP)								
Asset stewardship incentive								
Volume incentive								
1 April 2009 RAB								
Note: As the separate price controls for Scotland and England & Wales started on 1 April 2006, this statement is for 2006/07.								
* Detailed note for other adjustments								
Other adjustments to be incorporated in April 2007 RAB (where relevant)								
Adjustment to reflect signalling review								
Adjustment to reflect possessions review								
Land disposal compensation								
Cost of meeting additional obligations								
Investments not approved by ORR								
Railway safety charge (difference)								
Other adjustments to be incorporated in April 2007 RAB								

Regulatory Accounting Guidelines

Statement 3: England & Wales Analysis of capital expenditure (renewals and enhancements) for the RAE

Figures in £m 05/06 prices unless stated

	Spend in the year		
	Actual	Indicative	Difference
	£m	determination £m	£m
Renewals included in the ACR2003			
Total renewals			
Enhancements included in the ACR2003			
Health & Safety schemes			
Train protection schemes			
LMD Pollution Prevention			
Other S&E Plan schemes			
Total Health & Safety			
<i>Emerging cost enhancements (transition schemes)</i>			
Southern Power Upgrade			
SRNTP (non-PSU)			
CTRL Blockade			
Thameslink 2000 development			
Total emerging cost schemes			
Telecoms enhancements			
WCRM enhancements			
Total enhancements in ACR03			
Investments not included in the ACR2003			
Government-sponsored schemes			
SRNTP: non-PSU works			
Others			
Total Government-sponsored schemes			
Network Rail-promoted schemes			
Schemes in DfT pot for discretionary spend*			
Tyseley South			
Peterborough-Werrington			
Other schemes (approved separately)			
Total NR-promoted schemes			
Schemes promoted by third parties			
Project Evergreen 2			
Others			
Total schemes promoted by third parties			
Other enhancement projects			
Total new investments			
Total renewals and enhancements			

* Separate note required showing breakdown between schemes and outputs

Statement 4: England & Wales Analysis of O, M & R expenditure

Figures in £m 05/06 prices unless stated

	Spend in the year		
	Actual £m	Indicative determination £m	Difference £m
Renewals			
Non-WCRM			
Track			
Structures			
Signalling			
Telecoms			
Electrification			
Plant and machinery			
Operational property			
Other (incl IT)			
Total non-WCRM			
Total WCRM renewals			
Total renewals			
Total Maintenance*			
Operating expenditure			
Controllable operating expenditure**			
Uncontrollable operating expenditure			
Total operating expenditure			
Total O, M & R			

* For the 05/06 regulatory accounts maintenance expenditure will be reported by asset category (or other appropriate activity breakdown).

** Including £xx million for staff costs and £yy million on production and management costs.

Statement 5: England & Wales Analysis of Income*Figures in £m 05/06 prices unless stated*

	Receipts in the year		
	Actual £m	Indicative determination £m	Difference £m
Franchised Track Access Income			
Fixed charge			
Usage charge			
Capacity charge			
EC4T			
Schedule 4 net payments			
Schedule 8 net payments			
Other contractual receipts			
Total Franchised Access Income			
Grant Income			
Total income from TACs and grants			
Other single till income			
Property income			
Freight income			
Open access income			
Stations income			
Depots income			
Third party funded enhancement schemes			
Other			
Total other single till income			
Total income			
Freight income			
Variable track access			
Capacity charge			
Performance regime			
Cancellations			
EC4T			
Other			
Total freight income			

Annex B: Definitions

Income

1. Network Rail is required to analyse its income on a basis that is consistent with the categorisation used in the ACR2003 final conclusions.
2. The revised categories to be identified are detailed in paragraphs 3-6 below (as per the pro forma in Annex A).
3. Franchise Access Income: income from passenger train operator customers operating under franchise agreements signed by the Strategic Rail Authority (SRA), DfT, Transport Scotland and/or a Passenger Transport Executive (PTE), including the following:
 - fixed charges – revenue derived from fixed track charges less RAB increase equivalent and additional grant proportion term as defined in Part 1 in Schedule 7 to franchised passenger operators' track access agreements;
 - usage charge – revenue derived from variable track usage charges as defined in Part 1 in Schedule 7 to franchised passenger operators' track access agreements;
 - capacity charge – revenue derived from variable track usage charges as defined in Part 1 in Schedule 7 to franchised passenger operators' track access agreements;
 - EC4T – revenue derived from traction electricity charges as defined in Part 1 in Schedule 7 to franchised passenger operators' track access agreements;
 - schedule 4 compensation – sums paid to (or received from) customers as required by Schedule 4 to franchised passenger operators' track access agreements;
 - schedule 8 reward – sums received from (or paid to) customers as required by Schedule 8 to franchised passenger operators' track access agreements; and

- other contractual payments – any other sums paid to (or received from) customers as a consequence of contractual requirements contained in franchised passenger operators' track access agreements and the associated Network Code.
4. Grant income: revenue from grants paid by the SRA (or any successor body) under any relevant deeds of grant between Network Rail and the SRA (or any successor body).
 5. Rebates: the total amount of any rebatable amounts paid to customers.
 6. Other single till income, including the following:
 - property income – revenue generated from the licensee's non-operational property portfolio, including the proceeds of disposals; and
 - freight income – net income from track access charges paid by freight train operators. This income will be further analysed between:
 - variable track access;
 - capacity charge;
 - performance regime;
 - cancellations;
 - EC4T; and
 - Other,
 - open access income – net income from track access charges paid by passenger train operators not operating under any form of franchise agreement;
 - stations income – net income from station access agreements;
 - depots income – net income from depot access agreements;
 - third party funded enhancement schemes – income from payments made by customers specifically in relation to enhancement schemes; and

- other income – income generated by the licensee from sources other than those described above.

Costs and expenditure

General

7. The following guidelines should be applied when preparing the regulatory accounts.
8. Income and expenditure will be recorded in the regulatory accounts on the same basis as it was treated in the ACR2003. In a number of cases this basis will be the approach adopted in the 2002/03 regulatory accounts. In certain cases the treatment of the costs will be presented differently in Network Rail's statutory accounts in order to comply with financial reporting standards.
9. In the event that the basis of allocating costs between any of the sub-categories changes, the fact should be disclosed in the narrative to the regulatory accounts.
10. Network Rail would not be required to include in the published regulatory accounts (although the information would still be provided to us) an item included in the templates where publication would or might seriously and prejudicially affect the interests of Network Rail and for this purpose Network Rail shall (except so far as ORR consents to Network Rail not doing so) refer for determination by ORR any question as to whether any such publication would or might seriously and prejudicially affect the interests of Network Rail.

Capitalisation of staff costs

11. In the regulatory accounts, capitalisation of staff costs as part of renewals and enhancement expenditure should be consistent with the approach adopted in 2002-03 (and definitions provided in FRS15, albeit relating to capital expenditure) and should result in:
 - staff costs only being capitalised when an employee has spent more than ten hours per week on an individual investment project;
 - the use of standard rates to translate hours into cost that differ from those used in 2002-03 only in respect of the rate of increase in average salaries plus national insurance contributions and pension costs;

- no capitalisation of staff costs in relation to management time or staff costs relating to managers who oversee a portfolio of different projects; and
- No capitalisation of staff costs in relation to abnormal time (e.g. idle capacity, delays, wasted materials etc).

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.

Materiality

13. The following expenditure should not be categorised as renewals expenditure:
- replacement of rail over a distance of less than 200 metres;
 - replacement of sleepers over a distance of less than 100 metres;
 - replacement of less than 1 in 4 sleepers over a distance of more than 100 metres;
 - replacement of hydraulic buffer units, drains or catch pits where the cost of individual components is less than £5,000;
 - replacement of timber longitudinal bearers on multispan bridges;
 - replacement or refurbishment of signalling equipment where the cost of individual components is less than £5,000;
 - replacement or refurbishment of electrification equipment where the cost of individual components is less than £5,000;
 - erection or replacement of fencing, walling, level crossing decking or pumping equipment where the cost of individual components is less than £5,000; and
 - painting of support signalling and telecoms structures where the cost is less than £5,000.

Structures and operational property

14. Structures and operational property: Network Rail's entire expenditure on structures and operational property should be categorised as renewals expenditure in order to be consistent with the treatment adopted in the ACR2003 final conclusions. This includes all expenditure on:
- underbridges, overbridges, footbridges, earthworks, coastal and estuarial defences, culverts, retaining walls and tunnels; and
 - stations, depots and lineside buildings.

Form of presentation

15. Renewals expenditure is to be classified between the following headings in a manner which is consistent with the basis for the ACR2003 final conclusions (see the pro forma in Annex A):
- track;
 - signalling;
 - electrification and plant;
 - structures;
 - telecoms;
 - operational property;
 - plant and machinery;
 - information systems expenditure; and
 - other expenditure.

Enhancements

16. Enhancement expenditure is defined as capital expenditure resulting in a change to network outputs, usually involving construction, that 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 capital expenditure (renewals and enhancements) for the RAB.*

Maintenance

17. Maintenance expenditure relates to activities that Network Rail carries out in order to sustain the condition and capability of the existing infrastructure but which do not involve significant replacement of assets. Such expenditure maintains the previously assessed standard of performance.
18. Maintenance expenditure includes:
 - expenditure incurred in repairing (but not replacing) infrastructure assets and routine over-hauls;
 - the cost of preventative work designed to protect assets from future failure;
 - the cost of asset inspection; and
 - the cost of all small-scale replacement work excluded from the definition of renewals expenditure in paragraph 13 of Annex B.
19. In calculating maintenance expenditure, Network Rail is required to apportion costs in a manner consistent with the policies adopted when compiling the 2002-03 regulatory accounts. Specific guidance on the apportionment of Network Rail's own staff costs, and production and management costs is set out below.

Allocation of staff costs to maintenance

20. Network Rail may only apportion staff costs to maintenance expenditure if:
 - the costs would previously have been borne by one of Network Rail's infrastructure maintenance contractors; or
 - the corresponding expenditure was apportioned to maintenance expenditure in 2002-03.

Allocation of production and management costs to maintenance

21. Network Rail should only apportion production and management costs to maintenance expenditure if:

- the costs would previously have been borne by one of Network Rail's infrastructure maintenance contractors; or
 - the corresponding expenditure was apportioned to maintenance expenditure in 2002-03.
22. As a general principle, overheads that Network Rail classified as operating expenditure in 2002-03 should not be apportioned to maintenance expenditure.

Form of presentation

23. We are working with Network Rail to ensure that from 2006/07 onwards the regulatory accounts will provide more detail on maintenance costs. Therefore, for 2006/07 onwards, the maintenance part of the template will be revised to provide more detail on maintenance costs.
24. For 2005/06, maintenance expenditure will be classified as shown in statement 4: *Analysis of O, M and R expenditure*.

Operations expenditure

25. Operations expenditure covers costs that are incurred in relation to the operation of the network e.g. signalling.

Form of presentation

26. We are working with Network Rail to ensure that from 2006/07 onwards the regulatory accounts will provide more detail on operations costs. Therefore, for 2006/07 onwards, the Analysis of O, M and R expenditure template will be revised to provide more detail on operations costs

Operating costs

27. Operating costs represent total operating costs consistent with the ACR2003 final conclusions. These operating costs will include maintenance costs, operations costs, other operating costs e.g. insurance and non-controllable operating expenditure e.g. cumulo rates. For the period to 31 March 2009 non-controllable operating expenditure only includes the following items :
- (a) costs payable to RSSB;
 - (b) cumulo rates;

- (c) British Transport Police costs; and
- (d) the ORR licence fee.

28. No other operating expense should be classified as non-controllable expenditure.

Definition of staff costs

29. Staff costs should include: total employment costs, including wages, bonuses, expenses, national insurance contributions, pension costs and any other staff benefits.

Form of presentation

30. We are working with Network Rail to ensure that from 2006/07 onwards the regulatory accounts will provide more detail on operating costs. Therefore, for 2006/07 onwards, the Analysis of O, M and R expenditure template will be revised to provide more detail on operating costs.

31. For 2005/06, operating costs should be analysed as shown in statement 4: *Analysis of O, M and R expenditure*.

Annex C: Enhancement reporting template

Revised enhancement reporting template

The licence holder should provide information on all enhancement schemes for which it is claiming a RAB addition during the year containing the following details:

- scheme name;
- business unit;
- type of scheme;
- asset category;
- current authorised stage;
- total CP1 expenditure;
- total CP2 expenditure (2001-04);
- expenditure (forecast and actual) by year for CP3 (2004-09);
- future years (beyond CP3);
- total expenditure;
- allocation of risk;
- contingency;
- funding method;
- value of any additional funding;
- date of addition to RAB;
- value of addition to RAB;
- rate of return;

- Is the scheme on the single enhancement list (or equivalent)?
- Does the scheme result from a competent authority notice? and
- project output(s) and expected dates of delivery.

Annex D: Conditions 22 and 29 of Network Rail's Network Licence

Condition 22: Regulatory Accounts

1. The purpose of this Condition 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 the Regulator 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.
2. In order to achieve the purpose referred to in paragraph 1, the licence holder shall prepare regulatory financial statements in relation to itself and, unless the Regulator otherwise consents, to Network Rail Infrastructure Finance (and shall for such purpose maintain accounting records) in accordance with the following paragraphs of this Condition and any Regulatory Accounting Guidelines from time to time issued by the Regulator.
3. The financial statements referred to in paragraph 2:
 - (a) shall be prepared in respect of the financial year ended 31 March 2002 and (save as otherwise provided in this Condition or the Regulatory Accounting Guidelines) thereafter on a consistent basis in respect of each succeeding financial year;
 - (b) shall be prepared such that, insofar as 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) the Regulator's valuation of the Regulatory Asset Base for the purpose of determining access charges; and
 - (ii) the Determination Assumptions for the corresponding period; (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, expenditure, profits and losses for the period 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 same period;
- (e) shall include narrative explaining the material variances from the previous year and from the Determination Assumptions; and
- (f) shall include the confirmation required under paragraph 3 of Condition 29.
4. 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 resources and financial resources and facilities of the licence holder for the period of 18 months commencing on the date of the statement.
5. The statement made under paragraph 4 shall be in one of the following terms: either:
- (a) "After making enquiries, and subject to the outcome of any access charges review which is due to be concluded within the 18 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;
- (ii) any mortgage, charge, pledge, lien or other form of security or other encumbrance; and
- (iii) any indebtedness or guarantee,

sufficient management resources and financial resources and financial facilities to enable the licence holder to carry on the activities authorised by its network licence in accordance with its obligations under the Act and under its network licence for the period of 18 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 18 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;
- (ii) any mortgage, charge, pledge, lien, or other form of security or other encumbrance; and
- (iii) any indebtedness or guarantee,

sufficient management resources and financial resources and financial facilities to enable the licence holder to carry on the activities authorised by its network licence in accordance with its obligations under the Act and under its network licence for the period of 18 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 management resources and

financial resources and financial facilities to enable the licence holder to carry on the activities authorised by its network licence in accordance with its obligations under the Act and under its network licence for the period of 18 months referred to in this statement."

6. The licence holder shall submit to the Regulator details of the main factors which the directors of the licence holder have taken into account in making the statement under paragraph 4. In the case of a statement of the kind contemplated by sub-paragraph (b) of paragraph 5 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 as specified therein.
7. The licence holder shall –
 - (a) notify the Regulator in writing immediately if its directors become aware of any circumstance that causes them no longer to have the reasonable expectation expressed in the statement made under paragraph 4 in the terms set out in sub-paragraph (a) or sub-paragraph (b) of paragraph 5; 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 the Regulator in such form and manner as the Regulator may direct.
8. The Regulator 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 therein;
 - (b) provide for appropriate segmental analysis and/or further breakdown of any items contained in the primary 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 the Regulator to monitor compliance with the conditions of this licence); and

- (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.
9. The licence holder shall procure a report by the Auditors addressed to the Regulator:
- (a) stating whether, in their opinion, the regulatory financial statements (other than those referred to in sub-paragraph (c) of this paragraph 9) 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 sub-paragraph (d) of paragraph 8 of this Condition has been prepared in accordance with the Regulatory Accounting Guidelines and is consistent with such expenditure presented in the primary financial statements.
10. Each statement made under paragraph 4 of this Condition shall be accompanied by a report prepared by the Auditors and addressed to the Regulator, stating whether the Auditors are aware of any inconsistencies between that statement and either the financial statements referred to in paragraph 2 or any information which the Auditors obtained in the course of their audit work for the licence holder and, if so, what they are.
11. 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 the Regulator may reasonably require for the exercise of his functions, including, in relation to monitoring, compliance by the licence holder with the Conditions of this licence.

12. The licence holder shall deliver to the Regulator a copy of the financial statements together with any information provided for in the Regulatory Accounting Guidelines, the Auditors' report referred to in paragraph 9 of this Condition and the statement referred to in paragraph 4 of this Condition 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 the Regulator). The financial statements, information, the Auditors' report referred to in paragraph 9 of this Condition and the statement referred to in paragraph 4 of this Condition, subject to any modifications approved by the Regulator, shall be published within one calendar month of delivery to the Regulator and thereafter made available to any member of the public on request.
13. With a view to enabling the licence holder to comply with its obligations under paragraph 2 of this Condition, the licence holder shall, unless the Regulator 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 the Regulator.
14. The licence holder shall:
 - (a) deliver to the Regulator evidence (including a copy of all such undertakings) that the licence holder has complied with the obligation to procure any undertaking pursuant to paragraph 13;
 - (b) inform the Regulator immediately in writing if the directors of the licence holder become aware that any undertaking procured pursuant to paragraph 13 has ceased to be legally enforceable or that its terms have been breached; and

- (c) comply with any direction from the Regulator to enforce any of the undertakings procured pursuant to paragraph 13.

15. 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;

“Determination Assumptions” means any assumptions (including their definitions and bases of measurement) from time to time notified to the licence holder by the Regulator as assumptions that have been used for determining access charges;

“Network Rail Infrastructure Finance” has the meaning ascribed to it by paragraph 17 of Condition 12;

“Regulatory Accounting Guidelines ” means any guidelines issued by the Regulator from time to time in accordance with paragraph 8 of this Condition; and

“Regulatory Asset Base” means the asset values as from time to time notified to the licence holder by the Regulator as being asset values that have been or are to be used for determining access charges.

Condition 29: Level of Financial Indebtedness

16. Except with the written consent of the Regulator, the licence holder shall ensure that as at the end of the financial year to which the financial statements prepared under Condition 22 relate:
- (a) the total amount of financial indebtedness of Network Rail Infrastructure Finance and any subsidiaries of Network Rail Infrastructure Finance shall not exceed 90 per cent of the Regulatory Asset Base of the licence holder applicable at that time; and
 - (b) 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 100 per cent of the Regulatory Asset Base of the licence holder applicable at that time.
17. Without prejudice to paragraph 1:
- (a) the licence holder shall use reasonable endeavours to ensure that the total amount of financial indebtedness of Network Rail Infrastructure Finance and any subsidiaries of Network Rail Infrastructure Finance shall not at any time exceed 85 per cent of the Regulatory Asset Base of the licence holder applicable at that time;
 - (b) if the total amount of financial indebtedness of Network Rail Infrastructure Finance and any subsidiaries of Network Rail Infrastructure Finance exceeds 85 per cent of the Regulatory Asset Base of the licence holder applicable at that time, the licence holder shall, within such time periods as the Regulator may notify as being appropriate in the circumstances:
 - (i) provide to the Regulator details of the steps it intends to take to reduce the amount to 85 per cent or below;
 - (ii) take those steps; and
 - (iii) provide to the Regulator evidence that it has taken those steps.
18. The licence holder shall provide, from time to time as requested by the Regulator and in any event every year in the regulatory financial statements it

prepares pursuant to Condition 22, 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 likely to comply, with paragraph 1 and (where applicable) with paragraph 2(b) of this Condition and, if so requested by the Regulator, evidence in support of that confirmation.

Interpretation

4. In this Condition:

“financial indebtedness” means any indebtedness of a financial nature of the relevant entity, for or in respect of:

- (a) moneys borrowed;
- (b) any acceptance credit;
- (c) any bond, note, debenture, loan stock or other similar instrument;
- (d) any redeemable preference share;
- (e) any finance or capital lease;
- (f) any foreign currency derivative transaction protecting against or benefiting from fluctuations in foreign exchange rates;
- (g) any other transaction (including any forward sale or purchase agreement) which has the commercial effect of a borrowing;
- (h) 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
- (i) any guarantee, indemnity or similar assurance against financial loss of any person in respect of any item referred to in paragraphs (a) to (g) above,

and for the purposes of this Condition:

- a) financial indebtedness:

- (i) is 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);
- (ii) excludes 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;
- (iii) excludes any financial indebtedness between the licence holder and any of its subsidiaries;
- (iv) excludes any financial indebtedness between any of the licence holder's subsidiaries;
- (v) excludes any financial indebtedness between Network Rail Infrastructure Finance and any of its subsidiaries;
- (vi) excludes any financial indebtedness between any of Network Rail Infrastructure Finance's subsidiaries; and
- (vii) excludes any derivative transaction other than as set out in paragraph (f) above;
- (j) where financial indebtedness denominated in a foreign currency is hedged by a derivative of the type set out in paragraph (f) above, the principal amount outstanding shall be calculated by reference to the sterling amount payable under the relevant derivative; and
- (k) total financial indebtedness shall be calculated net of any cash or cash equivalents held by the licence holder and Network Rail Infrastructure Finance or their subsidiaries;

"Network Rail Infrastructure Finance" has the meaning ascribed to it by paragraph 17 of Condition 12; and

"Regulatory Asset Base" has the meaning ascribed to it by paragraph 15 of Condition 22.

Annex E – Common cost and income allocation metrics

Network Rail expenditure category	Allocation metric	%age allocation to Scotland
OPEX		
Railway estates – general	Passenger train miles	9.592%
Safety and compliance – general	Track km	13.284%
BT Police/other joint industry	Total train miles	9.703%
Information systems	Head count	9.459%
Human resources	Head count	9.459%
National logistics	Maintenance and renewals	8.937%
Chief engineer	Total train miles	9.703%
Finance	Maintenance and renewals	8.937%
PLC adjustment – pension	Head count	9.459%
PLC adjustment – insurance	Total train miles	9.703%
PLC adjustment – rail safety charge and other	Total train miles	9.703%
Other HQ business units	Maintenance, renewals and opex	8.994%
MAINTENANCE		
Other nationally managed expenditure	Maintenance expenditure	9.292%
West Coast Route Modernisation	West Coast km	8.450%

RENEWALS		
West Coast	West Coast km	8.450%
Telecoms	Track km	13.284%
Plant and machinery	Track km	13.284%
IT	Head count	9.459%
Other renewals	Total train miles	9.703%

Network Rail income category	Allocation metric	%age allocation to Scotland
Property income - general	Standard allocation	10%
Freight	Freight Miles	10.541%
Open Access	Open access income	0%
Stations income	Stations income	7.867%
Depots income	% depots in Scotland	11.111%
Other (including ring fenced)	Other income and ring-fenced assets	1.914%