

IMPORTANT NOTICE

Neither an audit nor a review provides assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular whether any changes may have occurred to the financial information since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in the United Kingdom governing the preparation and dissemination of financial information differs from legislation in other jurisdictions.

RAILTRACK PLC

Regulatory financial statements
for the year ended
31 March 2002

REGULATORY FINANCIAL STATEMENTS 2002

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DIRECTORS' REVIEW

The Directors of Railtrack PLC are pleased to present the regulatory financial statements for the year ended 31 March 2002. The basis of preparation of these financial statements is significantly different to the basis used to prepare the statutory financial statements and is explained in detail below and in the accounting policies note.

Regulatory financial performance

The actual net regulatory asset base ("RAB") operating return for the year ended 31 March 2002 was £601 million compared with that in the Periodic Review of Railtrack's Access Charges: Final Conclusions published by the Rail Regulator in October 2000 ("the regulatory determination") of £488 million.

The RAB operating return reflects a 9.8% return on the average RAB, compared to the Rail Regulator's expected return of 8%. The increased return is as a result of excess property profits of £40 million (which are subject to clawback under the property allowance scheme) and various incentives of £66 million and enhancement overspend written back to RAB of £39 million.

The total operating return for the year, which includes income and expenditure on assets that are outside of the regulatory asset base, was £578 million. This total operating return of £578 million compares to a reported operating loss in the company's statutory accounts for the year ended 31 March 2002 of £1,078 million. A full reconciliation of the differences between these results is provided in Appendix A.

The most significant difference to note between the two sets of results is that, following the Rail Regulator's statement of 27 June 2002 in respect of the acquisition of Railtrack PLC by Network Rail, all renewals, maintenance, performance and other operating expenditure in excess of the amounts allowed by the regulatory determination for the year ended 31 March 2002 has been included as an increase in the RAB (as an adjustment carried forward to the next valuation of RAB in 2006) and treated as regulatory income (or a reduction in regulatory expenditure) in the regulatory financial statements. A similar treatment is not possible when preparing statutory financial statements as the excess expenditure on renewals, maintenance and schedule 8 performance penalties has not enhanced the company's fixed assets, and thus the increase in the RAB will only result in higher income in later years when the company receives commensurately higher access charges.

Regulatory financial position

The regulatory financial position of the company shows a total regulated asset valuation of £8,590 million compared with a regulatory determination of £7,356 million. The difference between the totals reflects the RAB adjustments that will be included in the 2006 RAB valuation, as permitted by the Rail Regulator's statement of 27 June 2002 explained above. Reasons for the excess spend are given below.

The 'logged up' valuation of the RAB at 31 March 2002 is £6,394 million which is £49 million higher than the regulatory determination of £6,345 million. The net total regulatory assets of Railtrack PLC at 31 March were £1,882 million compared with net assets reported in the statutory financial statements of £1,182 million. A net assets reconciliation is provided in Appendix B, with a reconciliation of the RAB and ring fenced assets to statutory fixed assets in Appendix C.

DIRECTORS' REVIEW

Material variations from the regulatory determination

Income

The main variance from the regulatory determination in terms of income is created by the impact of schedule 8 and schedule 4 performance costs which have reduced franchise access income by £411 million. This is a reflection of the work undertaken to regain control of the network post-Hatfield, outlined further below. The overall income variance compared with the determination is a positive variance of £73 million, as a consequence of the subsequent logging up of schedule 8 and schedule 4 costs as an adjustment to RAB in accordance with the Rail Regulator's statement of 27 June 2002, excess property profits and various incentive revenues.

Expenditure

The overall expenditure variance, before taking account of the Rail Regulator's statement, was a negative variance of £566 million. The most significant factors that have caused this expenditure variance are:

- **Track renewals and maintenance** have been subject to a complete review since Hatfield as Railtrack regained engineering control of the network. Key drivers for the increase in track renewals expenditure include an improved understanding of the condition of track assets and new information on the rate of degradation of track assets (including the emergence of Gauge Corner Cracking). The underlying drivers for the increase in maintenance include compliance with new (or clarified) standards, particularly in the aftermath of Hatfield, new maintenance activities as a result of further research undertaken following Hatfield (including rail grinding, train-borne ultrasonic inspections and the installation of new lubricators), the roll out of the Maintenance Information Management System work management system and the impact of changing activity levels on unit costs.
- **Train control renewals**, which comprises signalling and telecoms renewals, where the company has significantly underspent the regulatory determination. This reflects slower than originally planned development of the Fixed Telecom Network and GSM-R and deferral of signalling expenditure, particularly on the West Coast Route Modernisation ("WCRM") programme as the scope for Phase II has developed.
- **Other costs**, which comprise staff costs and other production and management costs have risen as a result of various items, particularly increased headcount (an 8% rise on the previous year), the increased pension charges for the Railtrack section of the Railways Pension Scheme as a consequence of a general fall in investment values, as well as the impact of provisions against claims, the increased costs of insurance and some feasibility costs written off.

RAB and RAB adjustments for 2006

As outlined below, adjustments for amounts spent in excess of the regulatory determination have been incorporated into the RAB as an accumulated adjustment carried forward to 2006, though any adjustment may be reflected earlier in the event of an interim review or an early periodic review. These adjustments total some £1,015 million. The reasons for the overspend are outlined above. In addition, other adjustments in respect of freight income shortfall following the withdrawal of the associated grant, volume, congestion, and broken rail incentives, deferred income and property renewals total £308 million. These latter income adjustments are

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DIRECTORS' REVIEW

entirely offset by the effect of the additional network grant of £351 million which has been received in advance of 2006 and, as such has been anticipated as a reduction in RAB.

DIRECTORS' REVIEW

Basis of preparation

Regulatory financial statements are required to be prepared by Railtrack PLC under the terms of its Network Licence dated 31 March 1994, as amended on 11 April 2001, ("the Licence"). This is a requirement which came into effect for Regulatory Control Period 2 ("CP2"), commencing on 1 April 2001, and these are therefore the first set of regulatory financial statements. The form of the regulatory financial statements is specified in Condition 22 of the Licence and the statements must be prepared in accordance with detailed Regulatory Accounting Guidelines issued by the Regulator in accordance with Condition 22.

The regulatory financial statements are prepared on a basis which differs significantly from UK generally accepted accounting principles ("UK GAAP"). Railtrack PLC's statutory accounts for the year ended 31 March 2002 have been filed with the Registrar of Companies and were prepared in accordance with UK GAAP. Appendix A includes a reconciliation of the operating loss in the statutory accounts to the total operating return reported in the regulatory financial statements.

The detailed regulatory accounting policies adopted are set out after the statement of regulatory financial position.

Fundamental Uncertainty – West Coast Route Modernisation ("WCRM")

In preparing the regulatory financial statements the directors have considered a fundamental uncertainty relating to WCRM. During the year the company has been seeking an agreement with Virgin Trains Limited ("Virgin"), the Strategic Rail Authority ("SRA") and the Rail Regulator on a revised contract and output specification in respect of WCRM. At the date of approval of the regulatory financial statements the SRA is conducting a review of the optimal capacity utilisation of the West Coast Main Line and of the infrastructure necessary to support this capacity.

There is a fundamental uncertainty as to the outcome of this review and it is not possible to quantify with any certainty the potential final costs of the project including any settlement with Virgin nor the extent to which the costs may need to be provided against in the regulatory financial statements at 31 March 2002. In the opinion of the directors it would be seriously prejudicial for the company to attempt to disclose any further information about the uncertainties or the potential financial effect of possible outcomes.

Post balance sheet events

In a statement dated 27 June 2002 the Rail Regulator published his views on the proposed acquisition of Railtrack PLC by Network Rail and outlined the licence modifications which he would propose to make on completion of the transaction. The statement set out, inter alia, the Rail Regulator's views on the additional funding which would be required by Railtrack PLC over the remainder of CP2. The Rail Regulator indicated that he proposes making certain adjustments to the RAB to reflect additional expenditure on operating, maintaining and renewing the network in the two years ended 31 March 2003 matched by an increase in the RAB, of which £1,015 million has been recorded in the year ended 31 March 2002. On 1 October 2002 the High Court ordered that Railtrack PLC be discharged from administration, which was the final condition precedent in the Network Rail sale agreement. The company became a subsidiary of Network Rail Limited on 3 October 2002.

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DIRECTORS' REVIEW

On 27 June 2002 the company's former parent undertaking, Railtrack Group PLC, entered into an agreement with Network Rail Limited and Network Rail Limited and Network Rail Holdco Limited (together "Network Rail") for the sale and purchase of the entire issued share capital of Railtrack PLC.

On 19 August 2002 the company purchased the entire issue share capital of Railtrack (Spacia) Limited for a consideration of £17 million.

By order of the board

John Armitt

Ron Henderson

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing regulatory financial statements in accordance with Condition 22 of the Network Licence dated 31 March 1994, as amended on 11 April 2001.

In preparing those regulatory financial statements, the directors are required by Condition 22 to:

- prepare the regulatory financial statements in respect of the year ended 31 March 2002 and (save as otherwise provided in Condition 22 or the Regulatory Accounting Guidelines) thereafter on a consistent basis in respect of each succeeding year;
- prepare the regulatory financial statements such that, insofar as reasonably practical, 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 as defined in Condition 22;(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);
- include, as a primary statement, a statement of regulatory financial performance comparing income, expenditure, profits and losses for the period with the Determination Assumptions;
- include all details reasonably necessary to reconcile in the primary statements with the annual statutory accounts for the same period.

In addition the directors are responsible for selecting suitable accounting policies where these are not directed by Regulatory Accounting Guidelines and for making judgements and estimates that are reasonable and prudent.

The board of directors are also required to formally approve the regulatory financial statements by signing the regulatory financial statements, comprising part A and part B of the regulatory financial performance.

In accordance with the Regulatory Accounting Guidelines the statutory financial statements are included as an attachment to these regulatory financial statements to enable a comparison. It should be noted that these statutory financial statements, which do not form a part of the regulatory financial statements, are covered by a separate audit engagement and opinion and are included for information only.

INDEPENDENT AUDITORS' REPORT TO RAILTRACK PLC AND THE OFFICE OF THE RAIL REGULATOR

In accordance with our terms of engagement dated 15 October 2002, we have audited the regulatory financial statements of Railtrack PLC for the year ended 31 March 2002 which comprise the statement of regulatory financial performance, the statement of regulatory financial position, the statement of accounting policies, the related disclosure statements 1 to 8 and the related appendices A to D.

The regulatory financial statements are separate from the statutory financial statements and have been prepared under the accounting policies set out therein which differ significantly from UK generally accepted accounting principles ("UK GAAP"). Financial information other than that prepared on the basis of UK GAAP does not necessarily represent a true and fair view of the financial performance or financial position of a company.

Respective responsibilities of directors and auditors

The nature, form and content of the regulatory financial statements are determined by the requirements of the Office of the Rail Regulator ("ORR"). It is not appropriate for the auditors or the directors to assess whether the nature of the information being reported upon is suitable or appropriate for the ORR's purposes. Accordingly, we make no such assessment.

As described in the statement of directors' responsibilities, the company's directors are responsible for the preparation of the regulatory financial statements in accordance with Condition 22 of Railtrack PLC's network licence dated 31 March 1994 as amended on 11 April 2001 ("Condition 22") and the regulatory accounting guidelines issued on 11 October 2002 in accordance with Condition 22 and subsequent additional guidance provided by the Office of the Rail Regulator ("the Regulatory Accounting Guidelines"). Our responsibility, as set out in our terms of engagement, is to audit the regulatory financial statements in accordance with those terms, relevant United Kingdom auditing standards and Condition 22.

We report to you our opinion as to whether the regulatory financial statements present fairly the regulatory financial performance of Railtrack PLC for the year ended 31 March 2002 and the regulatory financial position as at that date in accordance with the requirements of Condition 22 and the Regulatory Accounting Guidelines and have been prepared in accordance with those same requirements. We also report to you if, in our opinion, the Company has not kept proper accounting records, the regulatory financial statements are not in agreement with the underlying accounting records and regulatory returns, or if we have not received all the information and explanations we require for our audit.

We read the Directors' Review and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the regulatory financial statements.

Our report is prepared solely for the confidential use of Railtrack PLC and the Office of the Rail Regulator, and solely for the purpose of Railtrack PLC's compliance with the obligations of its licence. It may not be relied upon by you for any other purpose whatsoever. Deloitte & Touche neither owes nor accepts any duty to any other party and shall not be liable for loss, damage or expense of whatsoever nature which is caused by their reliance on our report.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the regulatory financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the regulatory financial statements. It does not include an assessment of whether the accounting policies are appropriate to the circumstances of the company where these are laid down by the Regulatory Accounting Guidelines. Where the Regulatory Accounting Guidelines do not give specific guidance on the accounting policies to be followed, our audit includes an assessment of whether the accounting policies adopted in respect of the transactions and balances required to be included in the regulatory financial statements are consistent with those used in the preparation of the statutory financial statements of Railtrack PLC.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the regulatory financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated whether the presentation of information in the regulatory financial statements was adequate overall to comply with the Regulatory Accounting Guidelines.

Our opinion on the regulatory financial statements is separate from our opinion on the statutory financial statements of the company, which are prepared for a different purpose.

Fundamental uncertainty

In forming our opinion, we have considered the adequacy of disclosures made in the statement of accounting policies included in the regulatory financial statements, concerning a fundamental uncertainty relating to the West Coast Route Modernisation (“WCRM”). During the year the company has been seeking an agreement with Virgin Trains Limited (“Virgin”), the Strategic Rail Authority (“SRA”) and the Office of the Rail Regulator on a revised contract and output specification in respect of the WCRM. At the date of approval of the regulatory financial statements the SRA is conducting a review of the optimal capacity utilisation of the West Coast Mainline and the infrastructure necessary to support this capacity.

There is a fundamental uncertainty as to the outcome of this review and it is therefore not possible to quantify with any certainty the potential final costs of the project including any settlement with Virgin or the extent to which they would need to be provided for in the statement of regulatory performance or the statement of regulatory financial position at 31 March 2002. Our opinion is not qualified in this respect.

Opinion

In our opinion the regulatory financial statements present fairly the regulatory financial performance of Railtrack PLC for the year ended 31 March 2002 and the regulatory financial position as at that date, and have been prepared, in accordance with the requirements of Condition 22 and the Regulatory Accounting Guidelines.

Deloitte & Touche
Chartered Accountants
London
29 November 2002

PART A – STATEMENT OF REGULATORY FINANCIAL PERFORMANCE

Year ended 31 March 2002

	Notes	Actual performance 2001/02 £m	ORR determination 2001/02 £m	Differen ce 2001/02 £m
INCOME				
Franchise access	DS3	1,256	1,707	(451)
Other single till	DS3	444	541	(97)
Property income	DS3	267	227	40
Adjustment c/f in 2006 RAB	DS2	709	128	581
Network grant	DS2	877	877	-
X-profiling accruals	DS2	458	458	-
Total		4,011	3,938	73
EXPENDITURE				
Renewals	DS4	(1,911)	(1,834)	(77)
Maintenance	DS4	(951)	(691)	(260)
Opex own costs	DS4	(860)	(605)	(255)
Joint industry costs	DS4	(294)	(320)	26
Adjustment c/f in 2006 RAB	DS2	561	-	561
Total		(3,455)	(3,450)	(5)
RAB ADJUSTMENTS				
RAB depreciation		-	-	-
Project gains and losses		39	-	39
Capitalised financing		6	-	6
Total		45	-	45
NET RAB OPERATING RETURN		601	488	113
CAPITALISED FINANCING OF REGULATORY ACCRUALS AND GRANTS				
		82		
RING-FENCED ACTIVITIES				
Ring-fenced revenues		-		
Project gains and losses		(139)		
Capitalised financing		34		
Return on ring-fenced activities		(105)		
TOTAL OPERATING RETURN		578		
INTEREST AND INFLATION ADJUSTMENTS				
Interest		(385)		
Decrease in market value of debt		62		
Inflation adjustment to RAB and other items		99		
		(224)		

PART A – STATEMENT OF REGULATORY FINANCIAL PERFORMANCE

Year ended 31 March 2002

TOTAL RETURN BEFORE TAXATION	<u>354</u>
Corporation tax prior year overprovision	20
Deferred taxation	-
TOTAL RETURN AFTER TAXATION	<u><u>374</u></u>

Approved by order of the board of directors on 29 November 2002

Signed on behalf of the board of directors

John Armitt

Ron Henderson

PART B – STATEMENT OF REGULATORY FINANCIAL POSITION

Year ended 31 March 2002

	Notes	Actual performance 2001/02 £m	ORR determination 2001/02 £m	Difference 2001/02 £m
ASSET BASE ANALYSIS				
RAB	DS1	6,394	6,345	49
Deferred network grants	DS2	746	749	(3)
Advance grant payments	DS2	(351)	(350)	(1)
RAB adjustments for 2006	DS2	1,323	134	1,189
X-profiling	DS2	478	478	-
Regulated total		8,590	7,356	1,234
Ring-fenced and other assets	DS1	538		
		9,128		
Working capital		(1,290)		
Working capital amount included in initial RAB		478		
Net operating assets		8,316		
Net debt		(6,423)		
Tax balances - Deferred taxation		-		
– Corporation tax	App D	(11)		
Net total regulatory assets		1,882		
Average RAB		6,119	6,090	29
NET RAB OPERATING RETURN ON AVERAGE RAB		9.8%	8.0%	1.8%
Average net total regulatory assets		1,695		
TOTAL RETURN ON AVERAGE NET TOTAL REGULATORY ASSETS		22.1%		

Approved by order of the board of directors on 29 November 2002

Signed on behalf of the board of directors

RAILTRACK PLC

PART B – STATEMENT OF REGULATORY FINANCIAL POSITION

Year ended 31 March 2002

John Armitt

Ron Henderson

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2002

Regulatory financial statements are required to be prepared by Railtrack PLC under the terms of its Network Licence dated 31 March 1994, as amended on 11 April 2001, ("the Licence"). This is a requirement which came into effect for Regulatory Control Period 2, commencing on 1 April 2001, and these are therefore the first set of regulatory financial statements. The form of the regulatory financial statements is specified in Condition 22 of the Licence and the statements must be prepared in accordance with detailed Regulatory Accounting Guidelines issued by the Regulator in accordance with Condition 22.

The regulatory financial statements are prepared on a basis which differs significantly from UK generally accepted accounting principles ("UK GAAP") and do not constitute statutory accounts within the meaning of Section 240 of the Companies Act 1985. Railtrack PLC's statutory accounts for the year ended 31 March 2002 have been filed with the Registrar of Companies and were prepared in accordance with UK GAAP. The report of the auditors on the accounts filed with the Registrar of Companies was unqualified and did not contain a statement under Section 237(2) or (3) of the Companies Act 1985. Appendix A includes a reconciliation of the loss in the statutory accounts to the total operating return reported in the regulatory financial statements.

Fundamental uncertainty – West Coast Route Modernisation ("WCRM")

In preparing the regulatory financial statements the directors have considered a fundamental uncertainty relating to WCRM. During the year the company has been seeking an agreement with Virgin Trains Limited ("Virgin"), the Strategic Rail Authority ("SRA") and the Rail Regulator on a revised contract and output specification in respect of WCRM. At the date of approval of the financial statements the SRA is conducting a review of the optimal capacity utilisation of the West Coast Mainline and of the infrastructure necessary to support this capacity.

There is a fundamental uncertainty as to the outcome of this review and it is not possible to quantify with any certainty the potential final costs of the project, including any settlement with Virgin, nor the extent to which the costs may need to be provided against in the regulatory financial statements at 31 March 2002. In the opinion of the directors it would be seriously prejudicial for the Company to attempt to disclose any further information about the uncertainties or the potential financial effect of possible outcomes.

Going concern basis

The company's statutory financial statements were prepared on the going concern basis, which is a fundamental accounting concept under UK GAAP. The statutory financial statements explained the basis of the directors' conclusions that the business was a going concern at that date and would continue to be so for at least 12 months from the date and signing those financial statements. The Regulatory Accounting Guidelines do not specifically state that the going concern basis should be applied in preparing the regulatory financial statements. However where, in the absence of specific guidance in the Regulatory Accounting Guidelines, accounting policies have been based on those used in the statutory financial statements, the going concern basis has been applied.

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2002

Accounting policies

(a) Accounting convention and basis of consolidation

The regulatory financial statements have been prepared in accordance with the Regulatory Accounting Guidelines issued by the Rail Regulator in accordance with Condition 22 of the Network Licence and additional guidance provided by the Office of the Rail Regulator ("RAGs"). The regulatory financial statements include regulatory valuations that are adjusted for the effects of inflation and follow a financial capital maintenance approach under a discounted present value methodology. Accordingly items in the accounts are included on a current value or value in use basis.

The financial statements are prepared for Railtrack PLC only, as the licence holder, therefore excluding any results or assets of Railtrack PLC's subsidiaries included in the consolidated Railtrack PLC statutory financial statements.

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2002

(b) Income and expenditure

Income and expenditure in respect of which the Rail Regulator made an assumption in the October 2000 periodic review ("Determination Assumptions") is accounted for and classified on a consistent basis with those Determination Assumptions. In particular, income, renewals and maintenance spend are presented by asset category in disclosure statements 3 and 4; where there is a need to apply an allocative rule in order to obtain this information this rule is clearly stated.

(c) Performance regimes

Supplements to the access charges and bonuses receivable from, less penalties payable to, customers are included in income. Additional contract amounts and bonuses payable to, less penalties receivable from suppliers and the Rail Regulator are included in expenditure. The Schedule 8 performance penalty includes a charge of £70 million for which a provision was made in the statutory financial statements for the year ended 31 March 2001, reducing the overall Schedule 8 charge in the statutory profit and loss account for the year ended 31 March 2002.

(d) Segmental analysis, cost allocation and transfer pricing

Cost attribution and allocation policies relating to other transactions and arrangements are allocated in relation to the way resources are consumed. Direct costs are allocated in the way in which they are incurred and indirect costs are allocated using a methodology having regard to the materiality of the allocations.

(e) Asset valuation

The Rail Regulator's valuation of the RAB is based on a rolled forward initial market value assessment. The regulatory balance sheet therefore includes the value of net investment that is expected to be included in the Rail Regulator's valuation at the next or subsequent periodic reviews.

The item in the balance sheet, the RAB account, is the accounting valuation of the RAB using a methodology consistent with that used by the Rail Regulator in the his Determination Assumptions. It does not represent the Rail Regulator's valuation but is an estimation of the economic value of past investment and activities that will be remunerated through allowed returns on the RAB in future years.

Adjustments to the RAB account are made in accordance with the methodology used in the Rail Regulator's 2000 periodic review subject to the following:

- the RAB account is increased by eligible (or potentially eligible) enhancement expenditure as incurred;
- provision is made for the depreciation taken into account in setting single till charges (depreciation assumed as part of the Determination Assumptions is set out in Part IV of the RAGs);
- provisions reducing the RAB account have been made in respect of ineligible enhancement expenditure and attributable financing costs. For instance costs which either:
 - (a) the Rail Regulator has formally indicated will not be remunerated through allowed returns on the RAB in future years; or

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2002

(b) Railtrack has decided are ineligible and will not be put forward for logging up into the RAB;

- adjustments are included which increase the RAB account in respect of amounts reasonably certain to be allowed in excess of eligible enhancement expenditure and attributable financing costs incurred, for example as a result of savings in enhancement expenditure;
- the RAB account is also increased by financing costs to the extent that they are expected to be recognised and they are calculated to show an 8% rate of return on the arithmetic average of relevant opening and closing balances;
- the RAB is increased to reflect the effect of general inflation between the start and end of the year in respect of opening balances (the movement in the RPI from March to March) and the effect of general inflation between the transactions in the year and the end of the year (the movement from the average RPI in April to March to the RPI in March at the end of the year).

The same process is followed in calculating the ring-fenced asset base, although this is not regulated. Additions are logged up where they are considered to be covered by anticipated remuneration. Depreciation is provided against ring-fenced assets once capitalised.

(f) Adjustments to be carried forward to 2006 RAB

In his 2000 periodic review the Rail Regulator made provision for a number of adjustments to the RAB in 2006 in respect of items other than enhancements. Further adjustments were anticipated in the SRA agreement with Railtrack of 2 April 2001 and in paragraphs 57 to 62 of the Regulator's statement published on 27 June 2002 in relation to the proposed acquisition of Railtrack PLC by Network Rail Limited. These relate to:

- additional expenditure in excess of the original determination incurred before April 2003; and
- reprofiling of SRA grants as agreed between Network Rail and the SRA.

The accrued present value of future adjustments to the RAB has been included in the statement of regulatory financial position, using a real discount rate of 8%. The unwinding of discounts is credited to the statement of regulatory financial performance as part of the return before interest and taxation (operating return).

(g) X-profiling

The 2000 periodic review provided for a profile of revenue over the control period which was different from the profile of costs. In order to report meaningful returns that are comparable with the rate of return provided for in the determination, Part IV of the RAGs explains the adjustments that are made to revenues and included in the balance sheet over the control period.

(h) Grants

Timing differences between the payment of revenue grants and the costs of management and provision of assets to which the grants relate are accounted for through the regulatory balance sheet and rolled forward with adjustments as appropriate for the effects of inflation and the capitalisation of financing. No account is taken of capital grants in these regulatory financial statements.

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2002

(i) Other assets and liabilities

Other balance sheet assets and liabilities are included in the accounts on a current value or value in use basis. To this extent the carrying value of net debt is stated at market value where this value differs materially from the historic book value.

Stocks and work-in-progress, other than on long term contracts, are stated at the lower of cost and net realisable value. Cost includes materials, direct labour and production overheads appropriate to the relevant stage of production. Net realisable value is based on estimated selling price less all further costs to completion and all relevant marketing, selling and distribution costs.

(j) Pension costs

The expected cost of providing pensions, as calculated periodically by professionally qualified actuaries, is charged so as to spread the cost over the service lives of employees in the scheme in such a way that the pension cost is a substantially level percentage of current and expected future pensionable payroll. Differences between the amount charged as costs for the year and payments made to schemes are treated as asset or liabilities in the balance sheet.

(k) Financial instruments

The Company uses various derivative products, principally interest rate swaps and forward rate agreements, to manage its exposure to interest rate fluctuations on its debt portfolio. Amounts payable or receivable in respect of these transactions are recognised as adjustments to interest expense over the period of the contracts. Termination payments made or received in respect of derivatives are spread over the life of the underlying exposure in cases where the underlying exposure continues to exist. In other cases any termination payments are taken to the profit and loss account. No transactions of a speculative or trading nature are undertaken. Financial instruments are not recognised in the balance sheet.

Monetary assets and liabilities expressed in foreign currencies are translated into sterling at rates of exchange ruling at the end of the financial year. Individual transactions denominated in foreign currencies are translated into sterling at the exchange rates ruling on the dates payment takes place, unless related or matching forward foreign exchange contracts have been entered into, then the rates specified in the relevant contracts are used.

(k) Financial instruments (continued)

The discount of principal and related fees associated with the issue of eurobonds and exchangeable bonds are accounted for as a reduction in the balance outstanding of the eurobonds and exchangeable bonds, and are amortised over the lives of the bonds. The amortisation charge is included within interest payable.

(l) Property clawback

Train operating companies are entitled to a share of any property gains and income (above certain thresholds). The total property clawback payable in respect of the year ended 31 March 2002 is calculated in Disclosure Statement 6.

(m) Taxation

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2002

Corporation tax

The corporation tax charge in respect of tax profits for the year, after taking into account adjustments to prior year estimates, is included in the regulatory financial statements, consistent with the tax shown in the statutory financial statements for the year.

Deferred taxation

Prudent provision has been made for deferred tax assets and liabilities arising from timing differences between the recognition of gains and losses in the regulatory financial statements and their recognition in a tax computation. The methodology as set out in a guidance note to be incorporated into the updated Regulatory Accounting Guidelines is as follows:

- consistent with the value in use basis, the deferred tax position should be calculated as the difference between the discounted value of pre-cash tax flows attributable to net assets currently held by the company, using an appropriate pre-tax discount rate (namely the value in use valuation), and the discounted value of the corresponding post-tax cash flows but discounted at an appropriate pre-tax discount rate;
- the balance sheet value of operating net assets can normally be reasonably assumed to be recoverable as revenues in the form of an annuity unless the Regulator indicates otherwise;
- tax cash flows on the assumed revenues for this purpose should be determined after taking account all future tax allowances that are available on account of transactions occurring on or before the balance sheet date but disregarding all other tax allowances except to the extent that they would be available on account of the assumed revenues. (Tax allowances are available in respect of transactions included in the Statutory Accounts as adjusted in accordance with legislation and practice);
- a post-tax, pre-debt discount rate consistent with the cost of capital assessment (namely a post-tax return on 5.6% would be consistent with a pre-tax return of 8.0% and tax of 30%) should be used to evaluate the resulting post-tax cash flows;
- the deferred tax assessment should be made separately for the operating component of the balance sheet, ie. excluding working capital balances (operating debtors and creditors);
- as no substantial tax timing differences are expected in respect of income and costs relating to working capital balances and financing balances, any deferred tax relating to these components may be disregarded unless it is considered likely that they could materially affect any deferred tax provision;
- full provision should be made on the balance sheet in respect of any deferred tax liability but any deferred tax assets that cannot be recovered against deferred tax liabilities may be disregarded on account of prudence; and
- if deferred tax is not provided for on account of it not being prudent to recognise a deferred tax asset, the company should disclose in a note to the regulatory financial statements the post-tax discount rate that would be consistent with the operating component (excluding working capital) of deferred tax having a zero value and the effective rate of tax on operating returns that is implied by that rate.

STATEMENT OF ACCOUNTING POLICIES

Year ended 31 March 2002

The provision may be significantly different from the provision calculated under UK GAAP due to the different treatments of gains and losses in the regulatory financial statements.

DISCLOSURE STATEMENT 1: TRACKING THE RAB AND ENHANCEMENT SPEND
Year ended 31 March 2002

	Movement in the year				ORR determ i- nation for RAB £m	Difference £m
	RAB £m	Ring- fenced £m	Other £m	Total £m		
MOVEMENT IN ASSET VALUES						
Opening value	5,801	330	-	6,131	5,801	-
Enhancement expenditure	435	289	62	786	410	(25)
Renewals adjustment						
- stations and depots	35	-	-	35	-	(35)
Capital Grants	-	-	(44)	(44)	(14)	(14)
Depreciation	-	-	-	-	-	-
Project gains and losses	39	(139)	-	(100)	-	(39)
Capitalised financing	6	34	-	40	-	(6)
Inflation	78	6	-	84	80	2
Closing value	6,394	520	18	6,932	6,345	49
ANALYSIS IN MARCH 2002 PRICES						
Balance at 1 April 2001	5,878					
Movements in 2001/02	516					
Closing value	6,394					
ANALYSIS OF ENHANCEMENTS	£m	£m	£m	£m	£m	£m
Train Protection	173	-	-	173	256	(83)
Platform Stepping	-	-	-	-	15	(15)
Shortlisted IOS schemes	1	-	-	1	59	(58)
Performance Related	1	-	-	1	11	(10)
Waterloo – Fawkham Jn	30	-	-	30	23	7
ECML Phase I	74	-	-	74	60	14
MFAS	14	-	-	14	42	(28)
Total allowances in 2001 RAB	293	-	-	293	466	(173)
Other schemes:						
Ring fenced	-	289	-	289	(*)	(*)
Other projects	142	-	62	204	(*)	(*)
	142	289	62	493	935	(442)

DISCLOSURE STATEMENT 1: TRACKING THE RAB AND ENHANCEMENT SPEND
Year ended 31 March 2002

Total	<u>435</u>	<u>289</u>	<u>62</u>	<u>786</u>	<u>1,401</u>	<u>(615)</u>
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	Actual net expenditure			ORR determination			Difference			Cumulative difference	
	2001	2002	etc	200	200	etc	200	200	etc	In outt	In 01/02
CUMULATIVE ANALYSIS	1/02	1/03	1/02	2/03	1/02	2/03	urn	2
	£m	£m	£m	£m	£m	£m	£m	£m	£m	es	es
RAB	435	-	-	<u>466</u>	<u>-</u>	<u>-</u>	<u>(31)</u>	<u>-</u>	<u>-</u>	<u>(31)</u>	<u>(31)</u>
Ring-fenced	<u>289</u>	<u>-</u>	<u>-</u>	<u>(*)</u>	<u>-</u>	<u>-</u>	<u>(*)</u>	<u>-</u>	<u>-</u>	<u>(*)</u>	<u>(*)</u>
Total	<u>724</u>	<u>-</u>	<u>-</u>								

(*) Determination data does not include separate analysis of ring-fenced and other projects enhancement spend.

DISCLOSURE STATEMENT 2: ADJUSTMENTS FOR NON-ENHANCEMENTS

Year ended 31 March 2002

	Movements in the year						Total £m
	Openin g value £m	Receipt of grant payme nts £m	Income adjust ments £m	Expendi ture adjustm ents £m	Capital ised financi ng £m	Inflatio n £m	
Volume incentive	-	-	46	-	2	-	48
Congestion charges	-	-	4	-	-	-	4
Adjustment to reflect 00/01 performance	-	-	-	-	-	-	-
Freight revenues	-	-	102	-	4	-	106
Broken rails adjustment	-	-	16	-	1	-	17
Project development costs	-	-	-	-	-	-	-
Possession compensation	-	-	-	-	-	-	-
IRSA cost pass through	-	-	-	1	-	-	1
Cost of meeting additional obligations	-	-	-	-	-	-	-
Deferred income	-	-	128	-	4	-	132
Additional network grants re 1 April 2001 letter	-	(337)	-	-	(13)	(1)	(351)
Other (Impact of ORR June Statement)	-	-	413	560	38	4	1,015
Adjustment to be incorporated in 2006 RAB	-	(337)	709	561	36	3	972
Network grants	-	(162)	877	-	28	3	746
Profiling adjustments to income	-	-	458	-	18	2	478

**Analysis of value by year of
movement,
March 2002 prices**

Balance at 1 April 2001 £m	Moveme nts in 2001/02 £m	Total £m
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DISCLOSURE STATEMENT 2: ADJUSTMENTS FOR NON-ENHANCEMENTS

Year ended 31 March 2002

Volume incentive	-	48	48
Congestion charges	-	4	4
Adjustment to reflect 00/01 performance	-	-	-
Freight revenues	-	106	106
Broken rails adjustment	-	17	17
Project development costs	-	-	-
Possession compensation	-	-	-
IRSA cost pass through	-	1	1
Cost of meeting additional obligations	-	-	-
Deferred income	-	132	132
Additional network grants re 1 April 2001 letter	-	(351)	(351)
Other	-	1,015	1,015
		<hr/>	<hr/>
Adjustment to be incorporated in 2006 RAB	-	972	972
		<hr/>	<hr/>
Deferred network grants	-	746	746
		<hr/>	<hr/>
Profiling adjustments to income	-	478	478
		<hr/>	<hr/>

DISCLOSURE STATEMENT 3: INCOME STATEMENT

Year ended 31 March 2002

	Actual performance 2001/02 £m	ORR determination 2001/02 £m	Difference 2001/02 £m
FRANCHISE ACCESS INCOME			
FIXED CHARGES			
Railway Safety charge	36	39	(3)
Base charge	1,352	1,387	(35)
Ring fenced charges	-	-	-
Schedule 4 supplements	18	18	-
Schedule 8 supplements	2	4	(2)
Other	2	-	2
TOTAL FIXED CHARGES	1,410	1,448	(38)
VARIABLE CHARGES			
Usage charge	160	154	6
Capacity charge	-	-	-
EC4T	133	141	(8)
Schedule 4 compensation	(52)	(22)	(30)
Schedule 8 bonus/penalty	(395)	(14)	(381)
TOTAL VARIABLE CHARGE	(154)	259	(413)
TOTAL FRANCHISE ACCESS CHARGES	1,256	1,707	(451)
OTHER SINGLE TILL			
Freight access	86	192	(106)
Open access	52	53	(1)
Station charges	262	255	7
Depot charges	42	39	3
Ring fenced charges	-	-	-
Other	2	2	-
Subtotal	444	541	(97)
Property income	267	227	40
TOTAL OTHER SINGLE TILL	711	768	(57)

DISCLOSURE STATEMENT 4: EXPENDITURE STATEMENT

Year ended 31 March 2002

	Actual performance 2001/02 £m	ORR determination 2001/02 £m	Difference 2001/02 £m
RENEWALS			
Track	802	553	(249)
Train control	454	737	283
Electrification	144	111	(33)
Structures	268	201	(67)
Station and depots	94	114	20
IS expenditure	55	79	24
Plant and machinery	89	33	(56)
Other	5	6	1
TOTAL RENEWALS	1,911	1,834	(77)
MAINTENANCE			
Track	530	385	(145)
Train control	240	175	(65)
Electrification	47	34	(13)
Other	134	97	(37)
TOTAL MAINTENANCE	951	691	(260)
OPEX OWN COSTS			
Signalling staff costs	211	148	(63)
Other staff costs	257	236	(21)
Other production and management	387	216	(171)
Property clawback	5	-	(5)
Other	-	5	5
TOTAL OWN COSTS	860	605	(255)
JOINT INDUSTRY COSTS			
Railway Safety	37	39	2
EC4T	98	121	23
Cumulo rates	119	119	-
BT police	34	34	-
Schedule 4 and 8 costs	-	-	-
ORR licence fee	6	7	1
FOC on TOC delay	-	-	-
TOTAL JOINT INDUSTRY	294	320	26

In accordance with paragraph 2.2 of the Regulatory Accounting Guidelines the above maintenance expenditure is allocated using the same pro-rata basis as that used in the Determination.

DISCLOSURE STATEMENT 4: EXPENDITURE STATEMENT
Year ended 31 March 2002

DISCLOSURE STATEMENT 5: RENEWALS AND MAINTENANCE COSTS BY ASSET
Year ended 31 March 2002

	Actual performance 2001/02 £m	ORR determination 2001/02 £m	Difference 2001/02 £m
WCRM			
Track	226	243	17
Train control	217	372	155
Electrification	107	61	(46)
Structures	33	37	4
Stations and depots	-	-	-
IT	-	-	-
Plant and machinery	1	-	(1)
Other	(1)	-	1
TOTAL WCRM	583	713	130
NON WCRM			
Track	1,106	695	(411)
Train control	477	540	63
Electrification	84	84	-
Structures	235	164	(71)
Stations and depots	94	114	20
IT	55	79	24
Plant and machinery	88	33	(55)
Other	140	103	(37)
TOTAL NON WCRM	2,279	1,812	(467)

WCRM includes Renewals only. No analysis of maintenance between non WCRM and Incremental WCRM is presently available, mainly because of the nature of maintenance contracts which do not analyse costs in this way.

DISCLOSURE STATEMENT 6: PROPERTY ALLOWANCE SCHEME
Year ended 31 March 2002

	Actual performance 2001/02 £m
PROPERTY INCOME	
Rentals	194
Sales	73
TOTAL INCOME	<u>267</u>
COSTS	
Rental incremental	3
Disposure expenses: Net book value	10
Disposal costs	7
TOTAL COSTS	<u>20</u>
NET RETURN	<u>247</u>
Property allowance	227
SURPLUS	<u>20</u>
Property clawback at 25% of surplus	<u>5</u>

DISCLOSURE STATEMENT 7: SEGMENTAL ANALYSIS

Year ended 31 March 2002

	Actual performance 2001/02 £m	ORR determination 2001/02 £m	Difference 2001/02 £m
NETWORK BUSINESS			
Income	1,550	(*)	(*)
Direct expenditure	(3,758)	(*)	(*)
	<u>(2,208)</u>		
NET OPERATING RETURN			
MAJOR STATIONS			
Income	114	(*)	(*)
Direct expenditure	(118)	(*)	(*)
	<u>(4)</u>		
NET OPERATING RETURN			
PROPERTY BUSINESS			
Income	267	227	40
Direct expenditure	(103)	(*)	(*)
	<u>164</u>		
NET OPERATING RETURN			
TOTAL (EX. RAILWAY SAFETY)			
Income	1,931	2,437	(506)
Direct expenditure	(3,979)	(3,480)	(499)
Accruals and adjustments	2,650	1,531	1,119
NET RAB OPERATING RETURN (excluding Railway Safety)	<u>602</u>	<u>488</u>	<u>114</u>

(*) Determination data does not include separate analysis of each segment of income and expenditure.

DISCLOSURE STATEMENT 8: GRANTS

Year ended 31 March 2002

	Grants received 2001/02 £m
REVENUE GRANTS	
Network grants identified in 19 October 2000 conclusions	
Payable 1 April	-
Payable 1 October – Received 16 November	162
Schedule 1 grants in respect of 1 April 2001 letter	
Payable 1 April	-
Payable 1 October – Received 1 October	337
TOTAL	499

**APPENDIX A: RECONCILIATION OF STATUTORY OPERATING PROFIT TO
REGULATORY TOTAL OPERATING RETURN**
Year ended 31 March 2002

		2001/02 £m
Operating loss per Statutory Accounts		(1,078)
Add: Profit on sales of properties		53
		<hr/>
Loss before Interest and Tax		(1,025)
Add Back:		
Capital grants amortised	(11)	
Depreciation and other amounts written off	1,915	
		<hr/>
		1,904
Less: Renewals		(1,911)
Adjustments:		
Adjustment to Network Grant Income	(104)	
Gauge Corner Cracking Adjustment	(70)	
Other adjustments in respect of fixed asset disposals	34	
		<hr/>
		(140)
Other items in Operating Return not recognised in statutory accounts:		
Adjustments c/f in 2006 RAB	1,270	
X-profiling accruals	458	
Capitalised Financing	122	
Project gains and losses	(100)	
		<hr/>
		1,750
Total operating return		<hr/> <hr/> 578

**APPENDIX B: RECONCILIATION OF STATUTORY NET ASSETS TO
REGULATORY NET ASSETS
Year ended 31 March 2002**

	£m	£m
Statutory net assets at 1 April 2001	2,250	
Add back taxation balances	291	
	<hr/>	
Statutory net assets at 1 April 2001 (excluding taxation balances)		2,541
Opening balance sheet adjustments:		
Difference between statutory fixed assets and regulatory RAB and ring fenced assets	(1,853)	
Capital gains excluded from regulatory net assets	534	
Schedule 8 performance accrual excluded from regulatory net assets	70	
Backlog provision included in regulatory net assets	(80)	
Adjustment to restate debt at market value	(144)	
Working capital amount included in initial RAB	471	
	<hr/>	
		(1,002)
		<hr/>
Regulatory net assets at 1 April 2001 (excluding taxation balances)		1,539
Total operating return		578
Interest and inflation		(224)
		<hr/>
Regulatory net assets at 31 March 2002 (excluding taxation balances)		1,893
		<hr/>
Taxation balances		(11)
		<hr/>
Regulatory net assets at 31 March 2002		<u>1,882</u>

**APPENDIX C: RECONCILIATION OF STATUTORY FIXED NET ASSETS TO
REGULATORY FIXED ASSETS**

Year ended 31 March 2002

	£m	£m
Net book value of statutory fixed assets at 31 March 2002		8,873
Amounts included in statutory financial statements not included in regulatory financial statements:		
Difference between statutory fixed assets and regulatory RAB and ring fenced assets at 1 April 2001	(1,853)	
Depreciation and other amounts written off fixed assets	1,915	
Renewals expenditure	(1,911)	
Capitalised interest/financing	(27)	
Fixed asset disposals and disallowed backlog expenditure	(4)	
Revaluation of investment property	(1)	
	<hr/>	(1,881)
Amounts included in regulatory financial statements not included in statutory financial statements:		
Net project gains and losses	(100)	
Inflation adjustment not included in statutory financial statements	84	
Capital grants received in the year	(44)	
	<hr/>	(60)
Regulatory fixed assets at 31 March 2002 (Disclosure Statement 1)		<hr/> <hr/> 6,932

APPENDIX D: OTHER NOTES

NOTE 1 – RELATED PARTIES

Year ended 31 March 2002

During the year to 31 March 2002 Railtrack PLC entered into the following transactions with related parties:

- Properties were sold to both Railtrack Developments Limited and Railtrack Spacia Limited for a total consideration of £16.5 million. All such transactions were on an arm's length basis, were valued by external third parties and were separately invoiced.
- Railtrack PLC provided to Railtrack Developments Limited and Railtrack Spacia Limited, both before and after administration, systems and administration resource to bill and recover property income on these companies' behalf, and has also incurred day-to-day property and management expenses. Prior to administration these expenses passed through intra-group accounts but after administration all such expenses were billed to Railtrack Developments Limited and Railtrack Spacia Limited, who in turn, billed Railtrack PLC for the income collected.
- Management services were also provided to Railtrack Telecom Services Limited and Railtrack Travel Limited. These charges related mainly to staff time incurred on these companies' projects.
- Railtrack PLC has in place insurance arrangements through Railtrack Insurance Limited, which became a subsidiary of Railtrack PLC on 25 March 2002 when it was acquired from Railtrack Group PLC for a consideration of £11 million.
- Railtrack PLC continues its relationship with Railway Safety which remained unaffected by administration.
- Railtrack pays an annual licence fee to ORR which is disclosed in DS4.
- During the course of the year the company provided technical advice and project management resource to Union Railways (South) Limited, a subsidiary of Railtrack Group PLC, in respect of construction of the Channel Tunnel Rail Link. All transactions were on an arm's length basis.
- Before the advent of administration the company provided services and facilities to Railtrack Group PLC, including the provision of office space, use of information technology, staff resources for payroll, accounting and corporate affairs functioning, treasury services and company secretarial resources. Subsequent to administration these resources were separated as far as possible with different facilities, premises and personnel. Where services continued to be shared, reimbursement of relevant costs were invoiced to Railtrack Group PLC.

APPENDIX D OTHER NOTES

NOTE 2 - CONTINGENT LIABILITIES AND POST BALANCE SHEET EVENTS

Year ended 31 March 2002

The SRA are conducting a review of the business case for the Thameslink project, including a review of the scope and timescale for completion. The outcome of this review is uncertain and it could result in Railtrack not receiving full value for the development work it has undertaken. The expenditure relating to Thameslink up to 31 March 2002 amounted to £147 million. The directors believe that it is likely that a proportion of this expenditure will not be remunerated, and accordingly have provided £100 million against the carrying value of the asset.

The company continues to negotiate with its principal partner for the West Coast Route Modernisation ('WCRM') with a view to addressing the significant commercial risks surrounding the project, including any compensation payable for late delivery and the possible methods of settlement. Further information is disclosed in the accounting policies.

On 5 October 1999 a collision and fire took place at Ladbroke Grove on the Great Western Main Line resulting in 31 deaths and a large number of serious injuries. There was also extensive damage to the infrastructure and to the trains involved. Police and HSE enquires are continuing and their outcome is awaited.

On 17 October 2000 a derailment occurred at Hatfield on the East Coast Main Line resulting in four deaths and a number of serious injuries. There was also extensive damage to the infrastructure and the trains involved. Police and HSE enquiries are continuing and their outcome is unknown.

On 27 June 2002 the company's former parent undertaking, Railtrack Group PLC, entered into an agreement with Network Rail Limited and Network Rail Holdco Limited (together 'Network Rail') for the sale and purchase of the entire issued share capital of Railtrack PLC. On 1 October the High Court ordered that Railtrack PLC be discharged from administration, which was the final condition precedent in the Network Rail sale agreement. The company became a subsidiary of Network Rail Limited on 3 October 2002.

On 19 August 2002 the Company purchased the entire issued share capital of Railtrack (Spacia) Limited for a consideration of £17 million.

SUPPLEMENTAL ZONAL EXPENDITURE STATEMENT
Year ended 31 March 2002

The methodology set out in note (m) to the Statement of Accounting Policies broadly seeks to value the tax allowances arising from the statutory financial statements and discount them over the projected pre-tax cash flows attributable to the regulatory net assets of the company.

This methodology differs from Financial Reporting Standard number 19 "Deferred Tax" ("FRS 19"). The most significant differences are as follows:

- The discount rate required to be used by FRS 19 is the post tax yield on Government bonds with maturity dates similar to those of the deferred tax assets or liabilities. The discount rate specified in the guidance note to be incorporated into the updated Regulatory Accounting Guidelines is higher and has the effect of decreasing the net present value of future liabilities and assets in the regulatory financial statements.
- Under FRS 19 deferred tax assets are recognised to the extent that they are recovered against suitable taxable profits. The Regulatory Accounting Guidelines only allow the recognition of deferred tax assets to the extent that they can be netted off against deferred tax liabilities. Any net deferred tax assets are not recognised.
- Short term timing differences are not recognised in the regulatory financial statements unless they have a material impact on the deferred tax asset or provision.

The deferred tax asset not recognised in the regulatory financial statements is in respect of the following:

	Taxation Losses	Timing difference s on fixed assets	Total £m
1 April 2001	277	590	867
Movement in the year	322	186	508
31 March 2002	<u>599</u>	<u>776</u>	<u>1,375</u>

The post tax discount rate consistent with the regulated assets of deferred tax having a zero value is 6.49%. Based on a pre tax cashflow of 8% this would imply an effective rate of tax on operating returns of 18.9%.

RAILTRACK PLC

SUPPLEMENTAL ZONAL EXPENDITURE STATEMENT

Year ended 31 March 2002