

**NATS (EN ROUTE) PLC**  
**REGULATORY ACCOUNTS 2011/12**

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The regulatory accounts were approved by the Board on 28<sup>th</sup> June 2012 and signed on its behalf by

Finance Director

  
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Nigel Fotherby

# **1 RESPONSIBILITIES IN RESPECT OF THE PREPARATION OF THE REGULATORY ACCOUNTS**

The Air Traffic Services Licence issued to NATS (En Route) plc ("NERL") requires NERL, in consultation with the Civil Aviation Authority (CAA), to draw up Regulatory Accounting Guidelines governing the format and content of the regulatory accounts and the basis on which they are to be prepared, and to prepare and publish regulatory accounts in conformity with the Regulatory Accounting Guidelines. The Guidelines currently in force (Issue 11, dated 18 June 2012) were approved by the CAA for application to this year's accounts on 19 June 2012.

## **2 PURPOSE AND BASIS OF PREPARATION**

### **2.1 Purpose of the regulatory accounts**

The purpose of the regulatory accounts, as set out in the Licence and the Regulatory Accounting Guidelines, is to make available such regulatory accounting information as will:

- (a) enable the CAA and the public to assess the financial position of NERL and the financial performance of the UK Air Traffic Services Business ("UKATS") and the En route (Oceanic) Business ("Oceanic") on a consistent basis, distinct from each other and its affiliate or related undertakings;
- (b) assist the CAA to assess NERL's compliance with the Licence;
- (c) assist the CAA and the public to assess performance against the assumptions underlying the current price control;
- (d) assist the CAA, the European Commission and the Performance Review Board to assess UKATS performance against the assumptions underlying the National Performance Plan (NPP) for Reporting Period 1 (RP1); and
- (e) inform future price control reviews and National Performance Plans.

### **2.2 Basis of preparation**

These accounts are prepared on the basis set out in the Regulatory Accounting Guidelines.

The regulatory accounts compare NERL's actual performance with the projections underlying the CAA's decision on the price controls, and are prepared on the basis used by the CAA when setting the price controls.

The price controls for Control Period 3 (CP3) were set by the CAA in December 2010<sup>1</sup>. The price controls for the UKATS business were on a calendar year basis and covered the four years starting 1 January 2011, while the Oceanic price controls were set on a financial year basis and covered the four years starting 1 April 2011. The regulatory accounts are presented on a financial year basis.

The accounts are prepared using amounts derived from the statutory accounts which are prepared on the basis of International Financial Reporting Standards (IFRS), details of which are given in the accounting policies note to the NERL statutory accounts. The Regulatory Accounting Guidelines require that these accounts do not reflect the adoption of IAS23: Borrowing Costs.

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<sup>1</sup> "NATS Price Control Review 2010-2014, CAA Decision" issued by the CAA in December 2010.

- **Regulatory performance**

The comparison of performance with the regulatory assumptions shows the derivation of UKATS and Oceanic regulatory profit and regulatory return, measured on a basis consistent with the basis used by the CAA when setting the price controls. The main changes compared with the statutory accounts basis are as follows:

- Operating costs are stated excluding accounting depreciation charges. The CAA's allowed regulatory depreciation (comprising underlying depreciation and, in the case of UKATS, the CAA's backlog adjustment to depreciation) is shown separately on the face of the table. See pages 6-11.
- Operating costs include cash pension costs instead of accounting pension costs. The cash contributions to the NATS defined benefit pension scheme assumed by the CAA are shown separately in the regulatory performance statements.
- Operating costs exclude any profit/loss on disposal of assets, as the disposal of assets is dealt with through the Regulatory Asset Base, rather than in the performance statement.

- **Movement in the regulatory asset base**

The statements on the Regulatory Asset Bases (RABs) show the movements in the UKATS and Oceanic RABs. The closing RAB is the opening RAB plus capital expenditure less the CAA's regulatory depreciation and plus/minus movements in working capital, with adjustments for the pension contribution variance, and capitalised financing costs.

Capital expenditure differs from the statutory accounts by £1.0m in 2011/12 (2010/11: £0.5m) as IAS23: Borrowing Costs is not applicable for the purposes of these accounts in accordance with the Regulatory Accounting Guidelines.

- **Operating cost efficiency rolling incentive mechanism**

This statement records the incremental out/(under)-performance against the profile of efficient operating expenditure assumed by the CAA when setting the UKATS and Oceanic price controls.

The four-year price control provides that NERL is able to retain, for up to five years, any out-performance achieved in the first three years of the control period, starting from 2011/12, through an increase to the RAB, providing the out-performance is sustained until the last year of the control period. Savings achieved in the final year of the price control will be accounted for in the Reference Period 2 ("RP2") review for the five years 2015 to 2019. Year by year the regulatory accounts will record the actual operating expenditure compared with the CAA projection, and calculate the out-performance compared with the previous year. The cumulative effect of operating cost out-performance by 2013/14 is the focus of this incentive mechanism. In its December 2010 decision on NERL's price control for CP3, the CAA made adjustments to the values of the RABs at the start of the third control period to reflect this out-performance.

- **Traffic levels**

A record of actual traffic levels is maintained, showing Total Service Units (TSUs) and Service Units (including civil exempt flights but excluding military and other exempt flights) for Eurocontrol, and chargeable flights for Oceanic, together with the traffic assumptions used by the CAA when setting the price control.

### **3 INDEPENDENT AUDITOR'S REPORT TO THE CIVIL AVIATION AUTHORITY ("CAA"), THE DIRECTORS OF NATS (EN ROUTE) PLC ("THE COMPANY") AND NATS HOLDINGS LIMITED ("NHL")**

We have audited the Regulatory Accounts of NATS (En Route) plc for the year ended 31 March 2012 which comprise the comparison of performance with the regulatory assumptions on pages 6-11, the movements in regulatory asset bases on pages 12-15, the operating cost efficiency rolling incentive mechanism on pages 16-17, the record of adjustments and potential clawbacks on pages 18-19, the record of the retail price index used in the regulatory calculations on page 20 and the record of traffic levels compared with the regulatory assumptions on page 21. These Regulatory Accounts have been prepared under the accounting policies set out therein.

This report is made solely to the Directors of the Company, NHL and the CAA ("the Regulator") in accordance with NERL's Air Traffic Services Licence ("the Licence"). Our audit work has been undertaken so that we might state to the Company, NHL and the Regulator those matters that we have agreed to state to them in our report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility for our audit work, for our report, or for the opinions we have formed to any other person other than those to whom we have agreed in writing to accept responsibility.

#### **Basis of preparation**

The Regulatory Accounts have been prepared under the historical and current cost conventions (as applicable) and in accordance with the Company's Regulatory licence, Regulatory Accounting Guidelines ("the RAGs") approved by the Regulator and the accounting policies set out in the statement of the basis of preparation. The Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared wholly under the basis of International Financial Reporting Standards ("IFRS"). Financial information other than that prepared on the basis of IFRS does not necessarily represent a true and fair view of the financial position of a Company as shown in the financial statements prepared in accordance with the Companies Act 2006.

#### **Respective responsibilities of the Regulator, Directors and auditor**

The nature, form and content of Regulatory Accounts are determined by the Regulatory Accounting Guidelines which have been drawn up by the Licensee in consultation with, and approval from, the Regulator. It is not appropriate for the auditor or the Directors to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly we make no such assessment.

The Directors are responsible for preparing the Regulatory Accounts in accordance with the Regulatory Accounting Guidelines as set out in the responsibilities in respect of the preparation of the regulatory accounts on page 2.

Our responsibility is to audit and express an opinion on the Regulatory Accounts in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board, except as stated in the "Basis of audit opinion" below, and having regard to the guidance contained in Audit 05/03 "Reporting to Regulators of Regulated Entities".

We report to the Directors of the Company, NHL and the Regulator our opinion as to whether the Regulatory Accounts have been properly prepared in accordance with the Regulatory Accounting Guidelines, and on that basis fairly present the regulatory financial performance of the Company, analysed between each separate segment as defined in the Regulatory Accounting Guidelines, and the regulatory financial position of the Company. We also report to you if in our opinion the Company has not kept proper accounting records or if we have not

received all the information and explanations, which we consider necessary for the purposes of our audit.

We read any other information contained within the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts.

### **Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the UK Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts. 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 accounts are consistent with those used in the preparation of the statutory financial statements of NHL.

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 Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under Auditing Standards.

Our opinion on the Regulatory Accounts is separate from the opinion on the statutory financial statements of the Company on which we reported on 28 June 2012, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "statutory" audit) was made solely to the Company's members, as a body, in accordance with Chapter 3 of part 16 of the Companies Act 2006. Our statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our statutory audit work, for our statutory audit report, or for the opinions we have formed in respect of that statutory audit.

### **Opinion**

In our opinion the Regulatory Accounts have been properly prepared in accordance with the Regulatory Accounting Guidelines, and on that basis fairly present the regulatory financial performance of the Company, analysed between each separate segment as defined in the Regulatory Accounting Guidelines, for the year ended 31 March 2012, and the regulatory financial position of the Company at 31 March 2012.



### **Deloitte LLP**

Chartered Accountants and Registered Auditor  
Southampton, United Kingdom  
28 June 2012

## 4 COMPARISON OF PERFORMANCE WITH THE REGULATORY ASSUMPTIONS

### 4.1 UK Air Traffic Services (UKATS)

#### UKATS Regulatory Performance Statement

Financial Year £ million <i>B/(W) = Better / (Worse)</i>	Current Year			Prior Year		
	Actual	CAA's CP3 Projection	Variance B/(W)	Actual	CAA's CP Projection	Variance B/(W)
Eurocontrol revenue	575.0	579.1	(4.1)	504.0	540.5	(36.5)
London Approach revenue	10.6	10.6	0.0	8.4	11.0	(2.6)
Price controlled revenue	585.6	589.8	(4.1)	512.4	551.4	(39.1)
Other income (Note 2)	68.2	64.4	3.7	65.9	57.3	8.6
Intercompany income	15.6	18.0	(2.4)	16.4	11.0	5.4
UKATS Revenue (including intercompany revenue)	669.4	672.2	(2.8)	594.6	619.8	(25.1)
Operating costs (Note 3)	337.2	361.1	23.9	343.6	391.9	48.2
Pension cash cost for Existing Employees (Note 4)			-	29.9	29.9	-
Defined Benefit Pension Cash Cost (Note 4)	93.3	93.3	-			
Underlying depreciation (Note 5)	163.0	163.0	-	149.2	149.2	-
Backlog adjustment to depreciation (Note 5)	(24.1)	(24.1)	-	(23.0)	(23.0)	-
Total costs	569.3	593.3	23.9	499.6	547.9	48.2
<b>Regulatory profit</b>	<b>100.1</b>	<b>78.9</b>	<b>21.2</b>	<b>95.0</b>	<b>71.9</b>	<b>23.1</b>
Capitalised Financing Costs for the year (Note 7)	(0.7)	-	(0.7)	3.8	-	3.8
<b>Regulatory return</b>	<b>99.4</b>	<b>78.9</b>	<b>20.5</b>	<b>98.8</b>	<b>71.9</b>	<b>26.9</b>
Average Regulatory Asset Base (RAB)	1,164.1	1,155.0	9.1	1,208.1	1,154.2	53.9
<b>Regulated rate of return (Note 8)</b>	<b>8.54%</b>	<b>6.83%</b>	<b>1.71%</b>	<b>8.18%</b>	<b>6.23%</b>	<b>1.95%</b>

See notes on pages 9 - 11.

## 4.2 Analysis of other UKATS income

<b>£ million</b>	<b><u>Current Year</u></b>	<b><u>Prior Year</u></b>
North Sea Helicopters	8.5	8.4
MoD	46.1	44.6
Consented services	2.6	1.7
Other external services	10.9	11.2
<b>Total</b>	<b><u>68.2</u></b>	<b><u>65.9</u></b>

<b>£ million</b>	<b><u>Current Year</u></b>	<b><u>Prior Year</u></b>
Eurocontrol revenue	575.0	504.0
Oceanic revenue	26.1	20.6
<b>Total</b>	<b><u>601.1</u></b>	<b><u>524.7</u></b>
Unregulated revenue UKATS	10.9	11.2
Unregulated revenue Oceanic	0.6	0.4
<b>Total</b>	<b><u>11.5</u></b>	<b><u>11.6</u></b>
% of unregulated revenue	1.9%	2.2%
Allowed %	4.5%	3.0%

As required by Condition 5, paragraph 12(a)(vi) of the NERL Licence, the external turnover of £10.9m arising from any other business as defined in the Licence does not exceed 4.5% of the aggregate turnover of the En route (UK) and En route (Oceanic) Businesses as defined in the Licence. Furthermore, as required by Condition 5, paragraph 12(b), the aggregate amount of all investments by NERL in the businesses described in paragraph 12(a)(vi) has not at any time exceeded 1% of the share capital in issue, share premium and consolidated reserves of NERL as shown by its most recent audited historical cost financial statements.

Consented services are those where, under Condition 5 of the NERL Licence, NERL has been granted specific consent by the CAA to conduct activity beyond core and specified services. These services are not included in any other business, as defined by Condition 5, paragraph 12(a)(vi) of NERL's licence.

## 4.3 Oceanic

### Oceanic Regulatory Performance Statement

£ million <i>B/(W) = Better / (Worse)</i>	<u>Current Year</u>			<u>Prior Year</u>		
	Actual	CAA's CP3 Projection	Variance B/(W)	Actual	CAA's CP Projection	Variance B/(W)
Shanwick Oceanic Control Area charges	26.1	26.5	(0.4)	20.6	24.7	(4.1)
Other revenue (Note 2)	0.6	0.6	0.0	0.4	-	0.4
<b>Total revenue</b>	<b>26.8</b>	<b>27.1</b>	<b>(0.3)</b>	<b>21.1</b>	<b>24.7</b>	<b>(3.6)</b>
Operating costs (Note 3)	13.7	14.4	0.7	14.4	18.4	4.0
Pension cash cost for Existing Employees (Note 4)				1.4	1.4	-
Defined Benefit Pension Cash Cost (Note 4)	4.0	4.0	-			
Depreciation (Note 5)	6.4	6.4	-	3.2	3.2	-
<b>Total costs</b>	<b>24.2</b>	<b>24.8</b>	<b>0.7</b>	<b>19.0</b>	<b>23.1</b>	<b>4.0</b>
<b>Regulatory profit</b>	<b>2.6</b>	<b>2.2</b>	<b>0.4</b>	<b>2.1</b>	<b>1.7</b>	<b>0.4</b>
Capitalised Financing Costs for the year (Note 7)	(0.0)	-	(0.0)	0.8	-	0.8
<b>Regulatory return</b>	<b>2.6</b>	<b>2.2</b>	<b>0.3</b>	<b>2.9</b>	<b>1.7</b>	<b>1.2</b>
Average RAB	38.5	40.5	(2.0)	32.7	21.6	11.1
<b>Regulated rate of return (Note 8)</b>	<b>6.67%</b>	<b>5.52%</b>	<b>1.15%</b>	<b>8.82%</b>	<b>7.69%</b>	<b>1.13%</b>

## 4.4 Charges to NERL from other group companies (see note 3)

### Inter company trading to NERL

£ million	<u>Current Year</u>	<u>Prior Year</u>
Charges from NATS Ltd	11.1	11.2
Charges from NATS (Services) Ltd	17.2	15.8
<b>Total</b>	<b>28.3</b>	<b>27.0</b>



**Notes to Performance Statements**

1. Performance is compared with the projection for CP3 included in the CAA's Decision (December 2010).
2. In the case of UK Air Traffic Services, Price Controlled Revenue is the revenue for Eurocontrol and London Approach, and Other Income is other external income included within UK Air Traffic Services; it is analysed in the table above (page 7). It includes £0.6m relating to the sale of emission credits, which is presented in the company's statutory accounts within Other operating income. In the case of Oceanic, Other Income is any income other than income from the Shanwick Oceanic Control Area charges.
3. Operating costs:
  - For the purposes of the price control, operating costs (which are derived from the statutory accounts and are on an accounting basis except where otherwise stated) are stated excluding accounting depreciation, accounting charges relating to the defined benefit pension scheme (see note 4 below), and profit/loss on disposal of assets. The disposal of assets is dealt with through the Regulatory Asset Base (RAB), rather than in the performance statement. For pensions and depreciation, see notes 4 and 5 below.
  - Operating costs include charges from other group companies; these charges to NERL, from NATS Ltd and NATS (Services) Ltd, are detailed in the table above (page 8).
  - Operating costs are stated after deducting capitalised internal labour costs. These amounted to £33.6m and £0.1m for UK Air Traffic Services and Oceanic respectively. The amounts included in the CAA CP3 projections are shown in the table below:

	2011/12	2012/13	2013/14	2014/15
£ million outturn				
<b>Capitalised internal labour costs included in the CAA CP3 projections</b>				
UK Air Traffic Services	38.1	36.9	37.7	37.6
Oceanic	1.3	1.9	1.5	0.7

- Operating costs include significant contributions to several European research and development initiatives (any funding on these programmes is included in other income).

<b>£ million</b>		<b>Current Year</b>	<b>Prior Year</b>
<b>Consented services:</b>			
SESAR Joint Undertaking	Income	2.4	1.7
	Operating costs	<u>(6.1)</u>	<u>(3.6)</u>
	Net cost	<u>(3.7)</u>	<u>(1.9)</u>
Functional Airspace Blocks	Income	0.3	0.0
	Operating costs	<u>(0.6)</u>	<u>0.0</u>
	Net (cost)/profit	<u>(0.3)</u>	<u>0.0</u>
<b>Other external services:</b>			
EGNOS	Income	0.4	0.3
	Operating costs	<u>(0.3)</u>	<u>(0.1)</u>
	Net (cost)/profit	<u>0.1</u>	<u>0.1</u>
SESAR Research Project	Income	0.0	0.1
	Operating costs	<u>0.0</u>	<u>(0.3)</u>
	Net (cost)/profit	<u>0.0</u>	<u>(0.1)</u>
<b>Intercompany:</b>			
NATSNV/ESSP	Income	0.7	0.7
	Operating costs	<u>(0.5)</u>	<u>(0.4)</u>
	Net profit	<u>0.2</u>	<u>0.2</u>
<b>TOTAL:</b>			
	Income	3.7	2.8
	Operating costs	<u>(7.5)</u>	<u>(4.4)</u>
	Net profit	<u>(3.8)</u>	<u>(1.7)</u>
Note: any small differences are due to rounding			

NB: The revenues in the table above only relate to income from European initiatives and form part of the overall total for other external services income disclosed in the Analysis of Other UKATS income on page 7.

4. NERL's cash pension costs are added back in.

- NERL closed its defined benefit pension scheme to new joiners with effect from 1 April 2009. Contributions to this scheme during CP3 are subject to the pension pass through arrangements. This means that variances to the CAA's assumption are recoverable in subsequent control periods. These variances are shown in Section 5.3 below.
- Pension costs relating to the defined contribution scheme are included in operating costs.
- For 2010/11 and other years in CP2, the allowance for defined benefit pension costs was limited to employees who were in the scheme before 1 January 2006. From 1 January 2011, the allowance includes the cost of all employees who were in the defined benefit scheme at that date. This recognised the

actions to reform pensions taken by the company in CP2 to manage the risk and cost of pensions.

5. The CAA's allowed regulatory depreciation is shown separately in the table. In the case of UKATS, the CAA's allowed depreciation comprises underlying depreciation and the CAA's backlog adjustment to depreciation.
6. The CP2 capitalised financing cost is the amount in respect of CP2 as calculated by the CAA during the CP3 price control review and is added to the RAB in the 2010/11 accounts for the start of CP3.
7. Capitalised financing costs for the year in respect of the capital expenditure variance and the pension contribution variance are added to the RAB to enable remuneration in future review periods. These financing costs are added to the regulatory profit for the calculation of the regulatory return.
8. The rate of return in the CAA's projection column for each year of CP3 averages to the allowed rate of return over the whole CP3. The profile of the returns year by year is shown below; the derivation is shown in Annex 3, section 4 of the Regulatory Accounting Guidelines

**Profile of Allowed returns (allowing for re-investment & price profiling)**

<b>£ million</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>
UK Air Traffic Services	6.76%	6.78%	6.76%	6.77%
Oceanic	5.38%	5.07%	5.73%	12.03%

The CAA has allowed a pre-tax real cost of capital of 7% for CP3. The profile of the returns in the table above is less than 7% because the CAA has applied the lower accounting rate of return to the average RAB. The accounting rate of return takes account of the fact that returns could be re-invested during the year, thereby generating the cost of capital by the end of the year. The allowed return for Oceanic is higher in 2014/2015 than the three preceding years because of the CAA's price profiling.

9. The amounts are stated in terms of average prices for the year. Hence some of the figures are slightly different from those in section 5 (the RAB) which are at year-end prices.
10. Any small differences in these schedules are due to rounding. Given the nature and purpose of these schedules, it is not considered appropriate to eliminate the rounding differences.

## 5 MOVEMENTS IN THE REGULATORY ASSET BASES

### 5.1 Movement in the UK Air Traffic Services regulatory asset base (RAB)

#### STATEMENT: MOVEMENT IN THE REGULATORY ASSET BASES

£ million	<u>UK Air Traffic Services</u>					
	<u>Current Year</u>			<u>Prior Year</u>		
	Actual	CAA's projection	Variance	Actual	CAA's projection	Variance
Opening RAB as at 1 April in opening prices	1,269.5	1,260.0	9.6	1,149.2	1,139.1	10.2
<i>The figures below are all at year end prices</i>						
Opening RAB restated at year end prices	1,314.9	1,305.0	9.9	1,210.7	1,200.0	10.7
<b>minus</b> RAB clawback	(142.1)	(142.1)	-			
<b>plus</b> CP2 RIM (Note 5)	29.6	29.6	-			
<b>Opening balance adjusted for year end prices and CP2 adjustments</b>	<b>1,202.3</b>	<b>1,192.4</b>	<b>9.9</b>	<b>1,210.7</b>	<b>1,200.0</b>	<b>10.7</b>
<b>plus</b> total capital expenditure at year end prices (Note 2), net of grants and customer contributions	126.4	139.3	(12.9)	122.1	105.7	16.4
<b>plus/minus</b> Defined Benefit Pension contribution variance (Note 3)	(1.0)	-	(1.0)			
<b>plus/(minus)</b> CP2 Pension Contribution Variance (Note 3)		-	-	37.6	-	37.6
<b>plus/(minus)</b> Capitalised Financing costs for the year (Note 4)	(0.7)	-	(0.7)	3.9	-	3.9
<b>minus</b> CAA's allowed underlying depreciation (Note 6)	(159.7)	(159.7)	-	(153.1)	(153.1)	-
<b>minus</b> CAA's amortisation of the CP2 RIM	(10.2)	(10.2)	-			
<b>add back</b> CAA's backlog adjustment to allowed depreciation (Note 7)	29.0	29.0	-	23.6	23.6	-
<b>plus/(minus)</b> increase/(decrease) in working capital (Note 8)	(21.8)	(31.2)	9.3	24.8	(6.5)	31.3
<b>Closing RAB as at 31 March</b>	<b>1,164.3</b>	<b>1,159.7</b>	<b>4.6</b>	<b>1,269.5</b>	<b>1,169.6</b>	<b>99.9</b>

See notes on pages 13 and 14.

## 5.2 Movement in the Oceanic regulatory asset base (RAB)

### STATEMENT: MOVEMENT IN THE REGULATORY ASSET BASES

£ million	Oceanic					
	Current Year			Prior Year		
	Actual	CAA's projection	Variance	Actual	CAA's projection	Variance
Opening RAB as at 1 April in opening prices	35.0	37.2	(2.2)	30.6	22.4	8.2
<i>The figures below are all at year end prices</i>						
Opening RAB restated at year end prices	36.3	38.5	(2.2)	32.2	23.6	8.6
<b>plus/(minus) CP2 RIM (Note 5)</b>	4.3	4.3	-			
<b>Opening balance adjusted for year end prices and CP2 adjustments</b>	40.5	42.7	(2.2)	32.2	23.6	8.6
<b>plus</b> total capital expenditure at year end prices (Note 2), net of grants and customer contributions	1.9	2.1	(0.3)	2.6	0.5	2.1
<b>plus</b> Defined Benefit Pension contribution variance (Note 3)	0.2	-	0.2			
<b>plus/(minus) CP2 Pension Contribution Variance (Note 3)</b>		-		1.8	-	1.8
<b>plus/(minus) Capitalised Financing costs for the year (Note 4)</b>	(0.0)	-	(0.0)	0.9	-	0.9
<b>minus</b> CAA's assumed underlying depreciation (Note 6)	(4.5)	(4.5)		(3.3)	(3.3)	-
<b>minus</b> CAA's amortisation of the CP2 RIM	(1.5)	(1.5)	-			
<b>add back</b> CAA's backlog adjustment to allowed depreciation (Note 7)	(0.6)	(0.6)	-			
<b>plus/(minus) decrease in working capital (Note 8)</b>	1.4	0.8	0.6	0.8	(0.0)	0.8
<b>Closing RAB as at 31 March</b>	<b>37.5</b>	<b>39.1</b>	<b>(1.7)</b>	<b>35.0</b>	<b>20.8</b>	<b>14.2</b>

### Notes

1. The methodology and formulae used by the CAA in the CP3 settlement are set out in Annex 4 of the Regulatory Accounting Guidelines.
2. Capital expenditure for the purpose of these tables is expenditure on property, plant and equipment. It also includes expenditure on fixed assets required under IFRS to be classified as intangible assets (principally software and assets relating to airspace re-sectorisation projects). It is stated net of proceeds of disposal and grants and other contributions to fixed assets. The RAB excludes any NERL capital expenditure on the Height Monitoring Unit as it is remunerated outside the price control.
3. The pension contribution variance measures the difference between actual cash pension contributions to the defined benefit pension scheme and the amount assumed by the CAA when setting the price control. The table in section 5.3 records the cumulative pension

contribution variance included in the RAB at each year end.

4. Capitalised financing costs for the year in respect of the capital expenditure and pension contribution variances are added to or deducted from the RAB to enable remuneration in future review periods.
5. An adjustment is added to the UKATS and Oceanic RABs in 2011/12 for the out-performance against the rolling incentive mechanism in CP2 (CP2 RIM). In addition a clawback adjustment to the UKATS RAB has been made to the opening RAB. This claws back the uplift made following financial restructuring in 2003.
6. The RAB is reduced by the allowed regulatory depreciation assumed in the price control, not by accounting depreciation.
7. In the case of UKATS, the CAA included a backlog adjustment to the amount of depreciation it allowed in setting the CP3 price control. This amount adjusts for the difference between the depreciation allowed during CP2 (including the price profiling adjustment) and what depreciation would have been based on actual capital expenditure in CP2.
8. Working capital for RAB purposes is defined as debtors and creditors, accruals and prepayments arising from trading (including transactions in respect of attributable fixed assets). It excludes any amounts relating to financing, tax, distributions, pension contributions and the price smoothing debtor.
9. The amounts are stated at year end price levels. Hence some of the figures are slightly different from those in section 4 (Comparison of Performance with the Regulatory Assumptions) which is stated in terms of average prices for the year.
10. Any small differences in these schedules are due to rounding. Given the nature and purpose of these schedules, it is not considered appropriate to eliminate the rounding differences.

### 5.3 Closing Cumulative Pension Contribution Variance included in the RAB

#### Closing Cumulative Pension Contribution Variance

<b>£ million</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>
UK Air Traffic Services	0.7	n/a	n/a	n/a
Oceanic	0.3	n/a	n/a	n/a

The closing cumulative pension contribution variance is the cumulative value of the pension contribution variances over CP3. At each year end, it is calculated in accordance with the formulae in the Regulatory Accounting Guidelines and is stated at year end prices.

The closing cumulative pension contribution variance includes the capitalised financing costs relating to the pension contribution variance accrued up to the end of the year. The difference in cumulative values will therefore be different to the pension contribution variance for the year recorded in the RAB statements, where the financing cost on both the pension contribution variance and the capital expenditure variance are shown in a separate line item.

The UKATS 2011/12 amount includes a carried forward variance of £1.6m relating to 2010/11.

## 6. OPERATING COST EFFICIENCY ROLLING INCENTIVE MECHANISM

<b>£ million, 2008/09 prices</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>
<b>UK Air Traffic Services</b>				
CAA Baseline	<b>306.8</b>	<b>304.0</b>	<b>302.8</b>	<b>301.9</b>
Actual Operating cost (Outturn):	337.2			
- less : redundancy , relocation cost	(1.6)			
- less : bad debt	(0.5)			
- less : cost of services to NSL	(12.1)			
Plus/(minus) variances in:				
Share plan costs from baseline levels	(2.6)			
Cost of non-regulated business from baseline levels	(0.1)			
Exceptional costs incurred associated with change of shareholding	-			
Sub-Total	320.2			
Multiplied by Within -year RPI growth index:	1.0147			
Sub-total	324.9			
Divided by RPI growth index from 2008/9:	1.1210			
Actual Operating Cost for RIM	<u>289.8</u>			
Out /(under) -performance 2011/12	17.0			
Out /(under) -performance 2012/13				
Out /(under) -performance 2013/14				
Out /(under) -performance 2014/15				
<b>Cumulative out-performance</b>	<b>17.0</b>			
<b>Cumulative benefit</b>	<b>17.0</b>			



<b>£ million, 2008/09 prices</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>
<b>Oceanic Services</b>				
CAA Baseline	<b>13.0</b>	<b>12.9</b>	<b>12.4</b>	<b>12.7</b>
Actual Operating cost (Outturn):	13.7			
- less : redundancy , relocation cost	(0.1)			
- less : bad debt	(0.1)			
- less : cost of services to NSL				
Plus/(minus) variances in:				
Share plan costs from baseline levels	(0.1)			
Cost of non-regulated business from baseline levels	0.1			
Exceptional costs incurred associated with change of shareholding				
Sub-Total	13.5			
Multiplied by Within -year RPI growth index:	1.0147			
Sub-total	13.7			
Divided by RPI growth index from 2008/9:	1.1210			
Actual Operating Cost for RIM	<b>12.2</b>			
Out /(under) -performance 2011/12	0.8			
Out /(under) -performance 2012/13				
Out /(under) -performance 2013/14				
Out /(under) -performance 2014/15				
<b>Cumulative out-performance</b>	<b>0.8</b>			
<b>Cumulative benefit</b>	<b>0.8</b>			

## Notes

1. The methodology for the operating cost efficiency rolling incentive mechanism is set out in the Regulatory Accounting Guidelines, Annex 4, section 5. The objective is to provide an incentive to NERL to make continuing savings in operating costs. In summary, the key steps are:
  - a Each year, the out/(under)-performance of actual costs against the CAA's assumptions is calculated.
  - b The incremental out-performance is calculated by comparing the out/(under)-performance for the year with the out/(under)-performance with the previous year. If less than zero, then the incremental out-performance is set to zero.
  - c At the end of the Control Period, the CAA carries out a discounted summation of the year-on-year incremental out-performances and adds this to the opening Regulatory Asset Base at the start of the next Control Period.
2. The definition of operating costs for the purpose of the operating cost efficiency rolling incentive mechanism is the operating cost from the Regulatory Performance statement less: bad debt costs, the costs of major site redundancies and major site staff relocations, cost of services to NSL and pension costs. In addition variances to exceptional costs (share plan, costs associated with a change in shareholding and non-regulated business from the baseline costs assumed for CP3) are excluded. In the case of Oceanic, and consistent with the basis used in the CAA projections, operating costs exclude the costs relating to the Height Monitoring Unit as these are remunerated outside the price control.
3. Any small differences in these schedules are due to rounding. Given the nature and purpose of these schedules, it is not considered appropriate to eliminate the rounding differences.

## 7 RECORD OF ADJUSTMENTS AND POTENTIAL CLAWBACKS

### 7.1 Tax Clawback

7.1.1 The methodology for calculating and adjusting for the tax benefit the licensee receives from adopting a higher level of gearing than assumed in the price control financial modelling is set out in Appendix 5 of the CAA Decision 2010. As set out in its May 2010 document, the CAA will implement the ex post adjustment which claws back from the licensee the revenue benefit it obtains from lower tax charges because of high gearing.

7.1.2 The clawback calculation takes the following steps:

- Step 1: Compare actual gearing to the target level of gearing of 60 percent. Gearing is defined and measured as set out in Condition 5 of the licence. If the simple average of actual gearing for the control period is lower or equal to the target gearing, then no clawback applies. If it is higher, then proceed to Step 2.
- Step 2: Compare actual interest to modelled interest. If actual interest costs used in the calculation of actual tax are lower or equal to the costs used to estimate the tax charge in the price decision, then no clawback applies. If they are higher, then proceed to Step 3.
- Step 3: The excess relief is calculated as actual interest less modelled interest. This is then multiplied by the statutory corporation tax rate used in the price determination, and uplifted by the CP3 cost of capital to reflect the time value of money. The resulting clawback adjustment is to be included in the opening CP4 RAB. The tax clawback is then apportioned to the UKATS and Oceanic RABs in proportion to the estimated opening RAB values at the start of CP4 broadly to reflect the relative size of the two businesses.

7.1.3 In calculating the tax uplift for CP4, the reduction in revenue (and the tax thereon) arising from the tax clawback should be excluded from the calculation.

7.1.4 For the purpose of this appendix, the RPI measure of inflation is to be used.

<b>STATEMENT: Tax Clawback adjustment</b>		
<b>UKATS &amp; Oceanic</b>	<b>2011/12</b>	
	<b>At 30th September</b>	<b>At 31st March</b>
	<b>Actual</b>	
Actual Gearing	57.73%	57.81%
Average Gearing for the period		<b>57.77%</b>

The average gearing calculation will be added to year by year with a calculation of the clawback provided in the final year of CP3.

## 7.2 Spectrum Charges

- 7.2.1 Due to uncertainty regarding the HM Government's position on Spectrum pricing, a risk sharing arrangement has been put in place whereby NERL bears up to 20 percent of any adverse variance from the aggregate amount of £0.9 million (in 2008/09 prices) assumed for the four years of CP3 subject to an absolute cap of £5 million on any shortfall to NERL during the course of CP3. In the event of a favourable variance, 80 percent of the variance would be returned to customers.
- 7.2.2 The CAA proposes that a true-up of these amounts would be effected through an equivalent adjustment to the opening RAB in the next control period.

<b>STATEMENT: SPECTRUM COST ADJUSTMENT (TO BE CARRIED FORWARD TO NEXT CP RAB)</b>				
<b>£ million</b>				
<b>UKATS</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>
Actual Spectrum Costs (outturn)	0.0			
RPI (base 2008/9)	1.1047			
Actual costs (2008/09 prices):	0.0			
CAA assumption (2008/09 prices)	0.1	0.2	0.2	0.4
Favourable/(adverse) variance	0.1			
<i>Proposed carry forward adjustment</i>	<i>0.1</i>			

## 8 RECORD OF THE RETAIL AND CONSUMER PRICE INDICES USED IN THE REGULATORY CALCULATIONS

### Record of RPI used in Regulatory Accounts

CHAW	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Average for year/mid year	214.8	215.8	226.5	237.3			
At 31 March (year end)	211.3	220.7	232.5	240.8			
At 31 August	217.2	214.4	224.5	236.1			

### Record of CPI index used in Regulatory Accounts (excludes housing payments such as mortgage interest payments and council tax)

D&BT	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Average for year/mid year	109.5	111.7	115.6	120.6			
At 31 March (year end)	109.8	113.5	118.1	122.2			
At 31 August	109.7	111.4	114.9	120.1			

**9 RECORD OF TRAFFIC LEVELS COMPARED WITH THE REGULATORY ASSUMPTIONS**

<b>UK Air Traffic Services</b>						
<b>Calendar Year</b>	<b>Service Units (000s)</b>		<b>Total Service Units (000s)</b>		<b>Flights (000s)</b>	
	CAA assumption	Actual	NPP assumption	Actual	CAA assumption	Actual
2011	9,797	9,715	9,971	9,860	2,253	2,213
2012	10,151		10,325		2,342	
2013	10,493		10,667		2,400	
2014	10,860		11,035		2,469	

Notes:

1. Service Units exclude military exempt flights and is the basis utilised in the Licence for the purposes of Eurocontrol revenue unit rate computations.
2. Total Service Units is the basis utilised by Eurocontrol for charging rates and includes military exempt flights, which are separately recovered by Member States. As NERL has a separate contractual arrangement with the military (which is incorporated into single till revenues for the purpose of calculating Eurocontrol charges), an adjustment is made to determined costs in the Eurocontrol charges to reflect the correct unit rates.
3. Flights are used to modulate certain aspects of the incentive payments/deductions relating to NERL’s service quality and environmental performance.

<b>Oceanic</b>		
<b>Financial Year</b>	<b>Flights (000s)</b>	
	CAA assumption	Actual
2011/12	399.5	404.0
2012/13	410.2	
2013/14	421.1	
2014/15	433.0	

Notes:

1. Oceanic flights are actual chargeable flights.

END OF REPORT

