

**NATS (EN ROUTE) PLC**  
**REGULATORY ACCOUNTS 2014/15**

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The regulatory accounts were approved by the Board on 25th June 2015 and signed on its behalf by

Finance Director



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 14) were approved by the CAA on 2 June 2015.

## **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 Enroute (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.  
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## 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 differences compared with the statutory accounts basis are as follows:

- Operating costs are stated excluding accounting depreciation charges. The CAA's allowed regulatory 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 expenditures associated with external contracts are excluded from the RABs.

Capital expenditure differs from the statutory accounts by £1.2m in 2014/15 (2013/14: £1.2m) 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 AUDITORS' 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) pic for the year ended 31 March 2015 which comprise the comparison of performance with the regulatory assumptions on pages 6 and 8, the movements in regulatory asset bases on pages 12-13, the operating cost efficiency rolling incentive mechanism on pages 16-17, the record of adjustments and potential claw backs on pages 19-20, the record of the retail price index used in the regulatory calculations on page 21 and the record of traffic levels compared with the regulatory assumptions on page 22. 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 auditors**

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 auditors 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. These responsibilities are set out on page 2 of the Regulatory Accounting Guidelines.

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 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 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 NERL Regulatory Accounts 2014-15 V7

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.

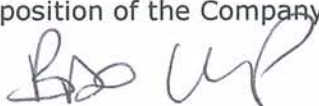
We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide use with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity 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 25 June 2015, 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 2015, and the regulatory financial position of the Company at 31 March 2015.

BDO LLP



Chartered Accountants and Registered Auditors

Southampton, United Kingdom

25<sup>th</sup> June 2015

## 4 COMPARISON OF PERFORMANCE WITH THE REGULATORY ASSUMPTIONS

### 4.1 UK Air Traffic Services (UKATS)

#### UKATS Regulatory Performance Statement

Financial Year - Outturn Prices £ million <i>B/(W) = Better / (Worse)</i>	Current Year			Prior Year		
	Actual	CAA's Projection	Variance B/(W)	Actual	CAA's Projection	Variance B/(W)
Eurocontrol revenue	612.4	625.1	(12.8)	614.9	638.4	(23.5)
London Approach revenue	12.1	12.1	0.0	10.8	11.6	(0.8)
Price controlled revenue	624.5	637.2	(12.7)	625.7	650.0	(24.3)
Other income (Note 2)	64.1	63.1	1.0	69.2	61.0	8.2
Intercompany income	22.4	21.1	1.3	20.8	19.9	0.9
UKATS Revenue (including intercompany revenue)	711.0	721.4	(10.4)	715.7	730.9	(15.2)
Operating costs (Note 3)	336.3	387.0	50.7	379.7	379.3	(0.4)
Defined Benefit Pension Cash Cost (Note 4)	74.0	74.0	-	87.8	87.8	-
Depreciation (Note 5)	181.4	181.4	-	183.6	183.6	-
Total costs	591.7	642.3	50.7	651.2	650.8	(0.4)
<b>Regulatory profit</b>	<b>119.3</b>	<b>79.1</b>	<b>40.3</b>	<b>64.5</b>	<b>80.1</b>	<b>(15.6)</b>
Capitalised Financing Costs for the year (Note 7)	(4.4)	-	(4.4)	(4.2)	-	(4.2)
<b>Regulatory return</b>	<b>115.0</b>	<b>79.1</b>	<b>35.9</b>	<b>60.3</b>	<b>80.1</b>	<b>(19.8)</b>
Average Regulatory Asset Base (RAB) (Note 9)	1,150.6	1,168.6	(18.0)	1,165.0	1,185.7	(20.8)
<b>Regulated rate of return (Note 8)</b>	<b>9.99%</b>	<b>6.77%</b>	<b>3.23%</b>	<b>5.18%</b>	<b>6.76%</b>	<b>-1.58%</b>

See notes on pages 9 - 11.

## 4.2 Analysis of other UKATS income

<b>Financial Year - Outturn Prices £ million</b>	<b><u>Current Year</u></b>	<b><u>Prior Year</u></b>
North Sea Helicopters	9.3	9.0
MoD	44.6	46.6
Consented services	3.5	3.8
Other contracts with the Crown	0.8	0.8
Contracts related to Functional Airspace Blocks	0.2	0.3
Other unregulated revenue	5.8	8.5
<b>Total</b>	<b><u>64.1</u></b>	<b><u>69.2</u></b>
<b>Sub-total: European Initiatives</b>		
Consented services	3.5	3.8
Functional Airspace Blocks	0.2	0.3
Included in Other unregulated revenue	1.1	0.8
<b>Total:</b>	<b><u>4.8</u></b>	<b><u>4.9</u></b>

### Analysis of NERL's unregulated income cap

<b>Financial Year - Outturn Prices £ million</b>	<b><u>Current Year</u></b>	<b><u>Prior Year</u></b>
En Route (UK) Business		
- Eurocontrol	612.4	614.9
- London approach	12.1	10.8
Sub-total	624.5	625.7
- Specified Services (North Sea Helis)	9.3	9.0
En Route (Oceanic) Business	27.0	26.2
<b>Total</b>	<b><u>660.8</u></b>	<b><u>660.9</u></b>
Unregulated revenue UKATS	5.8	8.5
Unregulated revenue Oceanic	0.5	0.6
<b>Total</b>	<b><u>6.3</u></b>	<b><u>9.1</u></b>
Unregulated revenue as % of total	1.0%	1.4%
Allowed %	4.5%	4.5%

As required by Condition 5, paragraph 12(a)(vi) of the NERL Licence, the external turnover of £6.3m 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. Other contracts with the Crown include contracts with the Met Office and recovery of exempt charges. Contracts performed by the UK/Irish FAB are also not included in unregulated revenue under paragraph 12(a)(v). Note that turnover excludes any income received in relation to capital projects that are fully funded by third parties and which are not included in the RAB. For 2014/15 this amounted to £2m. The return that NERL made on this income was consistent with the CAA allowance for CP3 (7% pre-tax real).

## 4.3 Oceanic

### Oceanic Regulatory Performance Statement

Financial Year - Outturn Prices £ 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	27.0	27.4	(0.3)	26.2	27.0	(0.8)
Other revenue (Note 2)	0.5	0.6	(0.1)	0.6	0.6	(0.0)
<b>Total revenue</b>	<b>27.6</b>	<b>28.0</b>	<b>(0.4)</b>	<b>26.8</b>	<b>27.6</b>	<b>(0.9)</b>
Operating costs (Note 3)	14.5	15.3	0.8	14.6	14.8	0.2
Defined Benefit Pension Cash Cost (Note 4)	3.2	3.2	-	3.8	3.8	-
Depreciation (Note 5)	5.7	5.7	-	7.1	7.1	-
<b>Total costs</b>	<b>23.4</b>	<b>24.2</b>	<b>0.8</b>	<b>25.5</b>	<b>25.6</b>	<b>0.2</b>
<b>Regulatory profit</b>	<b>4.1</b>	<b>3.7</b>	<b>0.4</b>	<b>1.3</b>	<b>2.0</b>	<b>(0.7)</b>
Capitalised Financing Costs for the year (Note 7)	0.3	-	0.3	0.0	-	0.0
<b>Regulatory return</b>	<b>4.4</b>	<b>3.7</b>	<b>0.7</b>	<b>1.3</b>	<b>2.0</b>	<b>(0.7)</b>
Average RAB (Note 9)	32.3	31.2	1.1	31.6	34.8	(3.2)
<b>Regulated rate of return (Note 8)</b>	<b>13.74%</b>	<b>12.03%</b>	<b>1.71%</b>	<b>4.17%</b>	<b>5.73%</b>	<b>-1.56%</b>

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

### Inter company trading to NERL

Financial Year - Outturn Prices £ million	<u>Current Year</u>	<u>Prior Year</u>
Charges from NATS Ltd	9.0	11.7
Charges from NATS (Services) Ltd	19.1	18.4
<b>Total</b>	<b>28.0</b>	<b>30.2</b>



## Notes to Performance Statements

1. Performance is compared with the projection for CP3 included in the CAA's Decision (December 2010, updated December 2011).
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). In the case of Oceanic, Other Income is any income other than income from the Shanwick Oceanic Control Area charges. IFRS requires discounting of long term receivables. These are adjusted in statutory and regulatory accounts for the impact of n+2 recoveries (e.g. traffic risk sharing, inflation, incentive schemes).
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, goodwill impairment, 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 £44.5m and £1.9m for UK Air Traffic Services and Oceanic respectively. The amounts included in the CAA CP3 projections are shown in the table below:

<b>Financial Year - Outturn Prices £ million</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>
<b>Capitalised internal labour costs included in the CAA CP3 projections</b>				
UK Air Traffic Services	38.9	37.8	38.2	38.0
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).
- The table overleaf shows net costs/profits relating to these initiatives.

## European Development Initiatives

<b>Financial Year - Outturn Prices</b>		<b>Current Year</b>	<b>Prior Year</b>
<b>£ million</b>			
<b>Consented services:</b>			
SESAR Joint Undertaking	Income	3.7	3.8
	Operating costs	<u>(6.6)</u>	<u>(5.8)</u>
	Net cost	<u>(2.9)</u>	<u>(2.0)</u>
Functional Airspace Blocks UK/Irish FAB	Income	0.0	0.1
	Operating costs	<u>0.0</u>	<u>(0.1)</u>
	Net (cost)/profit	<u>0.0</u>	<u>(0.0)</u>
Borealis	Income	0.2	0.2
	Operating costs	<u>(0.3)</u>	<u>(0.3)</u>
	Net (cost)/profit	<u>(0.0)</u>	<u>(0.0)</u>
<b>Other external services:</b>			
EGNOS	Income	0.0	0.1
	Operating costs	<u>(0.0)</u>	<u>(0.1)</u>
	Net (cost)/profit	<u>(0.0)</u>	<u>0.0</u>
SESAR Research Project	Income	0.1	0.3
	Operating costs	<u>(0.2)</u>	<u>(0.2)</u>
	Net (cost)/profit	<u>(0.2)</u>	<u>0.0</u>
<b>Intercompany:</b>			
NATSNV/ESSP	Income	0.8	0.5
	Operating costs	<u>(0.5)</u>	<u>(0.3)</u>
	Net profit	<u>0.3</u>	<u>0.2</u>
<b>TOTAL:</b>			
	Income	4.8	4.9
	Operating costs	<u>(7.6)</u>	<u>(6.7)</u>
	Net (cost)/profit	<u>(2.8)</u>	<u>(1.8)</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 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.
6. Research and development tax credits are included in the income statement for statutory accounts purposes. These are excluded from the regulatory performance statements.
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

<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)

Financial Year £ million	UK Air Traffic Services					
	Current Year			Prior Year		
	Actual	CAA's projection	Variance	Actual	CAA's projection	Variance
Opening RAB as at 1 April in opening prices	1,143.2	1,184.0	(40.8)	1,183.2	1,195.8	(12.6)
<i>The figures below are all at year end prices</i>						
Opening RAB restated at year end prices	1,153.5	1,194.6	(41.2)	1,212.2	1,225.2	(12.9)
<b>Opening balance adjusted for year end prices</b>	<b>1,153.5</b>	<b>1,194.6</b>	<b>(41.2)</b>	<b>1,212.2</b>	<b>1,225.2</b>	<b>(12.9)</b>
<b>plus</b> total capital expenditure at year end prices (Note 2), net of grants and customer contributions	136.8	140.8	(4.0)	109.3	142.9	(33.5)
<b>plus/minus</b> Defined Benefit Pension contribution variance (Note 3)	18.5	-	18.5	8.1	-	8.1
<b>plus/(minus)</b> Capitalised Financing costs for the year (Note 4)	(4.4)	-	(4.4)	(4.1)	-	(4.1)
<b>minus</b> CAA's allowed underlying depreciation (Note 5)	(186.5)	(186.5)	-	(179.8)	(179.8)	-
<b>minus</b> CAA's amortisation of the CP2 RIM	-	-	-	(10.8)	(10.8)	-
<b>add back</b> CAA's backlog adjustment to allowed depreciation (Note 6)	4.8	4.8	-	4.8	4.8	-
<b>plus/(minus)</b> increase/(decrease) in working capital (Note 8)	28.6	1.0	27.6	3.5	1.8	1.7
<b>Closing RAB as at 31 March</b>	<b>1,151.4</b>	<b>1,154.8</b>	<b>(3.4)</b>	<b>1,143.2</b>	<b>1,184.0</b>	<b>(40.8)</b>

See notes on pages 13 and 14.

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

Financial Year £ 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	31.6	32.7	(1.1)	31.5	36.3	(4.8)
<i>The figures below are all at year end prices</i>						
Opening RAB restated at year end prices	31.9	33.0	(1.1)	32.2	37.2	(5.0)
<b>Opening balance adjusted for year end prices</b>	<b>31.9</b>	<b>33.0</b>	<b>(1.1)</b>	<b>32.2</b>	<b>37.2</b>	<b>(5.0)</b>
<b>plus</b> total capital expenditure at year end prices (Note 2), net of grants and customer contributions	4.8	1.5	3.3	5.5	2.6	2.8
<b>plus</b> Defined Benefit Pension contribution variance (Note 3)	1.2	-	1.2	0.4	-	0.4
<b>plus/(minus)</b> Capitalised Financing costs for the year (Note 4)	0.3	-	0.3	0.0	-	0.0
<b>minus</b> CAA's assumed underlying depreciation (Note 5)	(5.1)	(5.1)	-	(5.1)	(5.1)	-
<b>minus</b> CAA's amortisation of the CP2 RIM	-	-	-	(1.6)	(1.6)	-
<b>add back</b> CAA's backlog adjustment to allowed depreciation (Note 6)	(0.6)	(0.6)	-	(0.6)	(0.6)	-
<b>plus/(minus)</b> decrease in working capital (Note 8)	0.3	0.2	0.1	0.7	0.1	0.6
<b>Closing RAB as at 31 March</b>	<b>32.8</b>	<b>29.0</b>	<b>3.8</b>	<b>31.6</b>	<b>32.7</b>	<b>(1.1)</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 and other unregulated programmes as these are 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.

An adjustment was added to the UKATS and Oceanic RABs in 2012/13 for the out-performance against the rolling incentive mechanism in CP2 (CP2 RIM).

5. The RAB is reduced by the allowed regulatory depreciation assumed in the price control, not by accounting depreciation.
6. In the case of both UKATS and Oceanic, 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 depreciation based on actual capital expenditure in CP2.
7. 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.
8. 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.
9. 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

<b>Financial Year - Outturn Prices £ million</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>
UK Air Traffic Services - Annual	(1.0)	(3.7)	8.1	16.7
UK Air Traffic Services - Final year adjustment				1.7
UK Air Traffic Services - Cumulative	(1.0)	(4.7)	3.3	21.8
Oceanic - Annual	0.3	0.2	0.4	1.2
Oceanic - Cumulative	0.3	0.5	0.8	2.0

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 excludes the capitalised financing costs relating to the pension contribution variance accrued up to the end of the year. The RAB statements reflect the financing cost on both the pension contribution variance and the capital expenditure variance as a separate line item.

The 2014/15 year contains an adjustment to reflect the position of the European Charging Regulation (see Note 10) on the UKATS pension variance, based on NERL's best estimate for the 2014/15 year end position and the amount to be included in the RAB. The capitalised financing costs on this adjustment amounts to a cumulative £0.5m and is reflected in the 2014/15 capitalised financing costs shown in the UKATS RAB statement.

The Oceanic RAB is not impacted by the Regulation.

## 6. OPERATING COST EFFICIENCY ROLLING INCENTIVE MECHANISM

Financial Year - 2008/09 Prices £ million	2011/12	2012/13	2013/14	2014/15
<b>UK Air Traffic Services</b>				
CAA Baseline	306.8	304.0	302.8	301.9
Actual Operating cost (Outturn):	333.8	331.6	374.7	
- less : redundancy , relocation cost	(1.6)	(1.3)	(39.7)	
- less : bad debt	(0.5)	(1.0)	(0.2)	
- less : cost of services to NSL	(12.1)	(14.3)	(16.6)	
Plus/(minus) variances in:				
Share plan costs from baseline levels	(2.7)	(1.2)	(3.5)	
Cost of non-regulated business from baseline levels	0.2	1.4	(0.4)	
London Approach price adjustment (Note 3)		(0.9)		
Sub-Total	317.2	314.3	314.4	
Multiplied by Within -year RPI growth index:	1.0147	1.0163	1.0123	
Sub-total	321.9	319.4	318.2	
Divided by RPI growth index from 2008/9:	1.1210	1.1578	1.1862	
Actual Operating Cost for RIM	287.1	275.9	268.3	
Out /(under) -performance 2011/12	19.7	19.7	19.7	19.7
Out /(under) -performance 2012/13		8.4	8.4	8.4
Out /(under) -performance 2013/14			6.4	6.4
<b>Cumulative out-performance</b>	19.7	28.1	34.5	



<b>Financial Year - 2008/09 Prices £ million</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>
<b><u>Oceanic Services</u></b>				
CAA Baseline	13.0	12.9	12.4	12.7
Actual Operating cost (Outturn):	13.7	14.0	14.5	
- less : redundancy , relocation cost	(0.1)	(0.1)	(1.2)	
- less : bad debt	(0.1)	(0.0)	(0.0)	
Plus/(minus) variances in:				
Share plan costs from baseline levels	(0.1)	(0.0)	(0.1)	
Cost of non-regulated business from baseline levels	0.1	0.2	0.2	
Sub-Total	13.5	14.0	13.4	
Multiplied by Within -year RPI growth index:	1.0147	1.0163	1.0123	
Sub-total	13.7	14.3	13.5	
Divided by RPI growth index from 2008/9:	1.1210	1.1578	1.1862	
Actual Operating Cost for RIM	12.3	12.3	11.4	
Out /(under) -performance 2011/12	0.7	0.7	0.7	0.7
Out /(under) -performance 2012/13		(0.2)	(0.2)	(0.2)
Out /(under) -performance 2013/14			0.4	0.4
<b>Cumulative out-performance</b>	0.7	0.6	1.0	

## **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, costs of inter-company services now directly charged (Luton and London City approach in the UKATS RIM, including a retrospective adjustment to the period 2011/12). 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. This amount was previously recognised as revenue in 2011/12. As a result of a NERL decision to price below the maximum permitted London Approach revenue in 2012/13, including an amount related to the prior year, an adjustment has been made to the 2012/13 statutory accounts. The adjustment reverses prior period revenues from 2011/12 which is reported as operating cost in the current period (with adjustments to the current period revenue reflected as reversals of revenue). For the purpose of the UKATS RIM, the adjustment to operating cost (from the prior period) has been reversed, in order to eliminate what is in effect a revenue adjustment.
4. 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 gearing above target.

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 RP2 broadly to reflect the relative size of the two businesses.

7.1.3 In calculating the tax uplift for RP2, 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.

STATEMENT: Tax Clawback adjustment									
UKATS & Oceanic	2011/12		2012/13		2013/14		2014/15		
	At 30th September	At 31st March	At 30th September	At 31st March	30-Sep	31-Mar	30-Sep	31-Mar	
	Actual		Actual		Actual		Actual		
Actual Gearing	57.7%	57.8%	56.7%	54.2%	52.4%	54.0%	53.6%	53.4%	
Average Gearing for the period									55.0%

The average gearing calculation will be added to year by year with a calculation of the clawback provided in the final year of CP3. As the outturn was below the target gearing level, no clawback adjustment is required.

## 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 where cost variances over the CAA assumptions for RP1 will be reported in 2008/9 prices. As stated in the Corrigendum to the UK-Ireland FAB Performance Plan for Reference Period 2, 100% of the variance will be carried forward, uplifted for actual inflation.
- 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, which will be on a calendar year basis. (favourable variances would be deducted, adverse variances added).

<b>STATEMENT: SPECTRUM COST ADJUSTMENT (TO BE CARRIED FORWARD TO NEXT CP RAB)</b>					
<b>Financial Year</b>					
<b>£ million</b>					
<b>UKATS</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>	<b>Total</b>
Actual Spectrum Costs (outturn)	0.0	0.5	(0.4)	0.2	0.4
RPI (base 2008/9)	1.1047	1.1392	1.1718	1.1951	
Actual costs (2008/09 prices):	<u>0.0</u>	<u>0.5</u>	<u>(0.3)</u>	<u>0.2</u>	<u>0.3</u>
CAA assumption (2008/09 prices)	0.1	0.2	0.2	0.4	0.9
Favourable/(adverse) variance	<u>0.1</u>	<u>(0.3)</u>	<u>0.5</u>	<u>0.2</u>	<u>0.6</u>

- 7.2.3 The cumulative amounts reflect the cost of radio spectrum only, as modifications to primary radars (2.66 GHz spacing) are included in the RAB, net of grants received.

## 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	244.7	251.7	256.7
At 31 March (year end)	211.3	220.7	232.5	240.8	248.7	254.8	257.1
At 31 August	217.2	214.4	224.5	236.1	243.0	251.0	257.0

### Record of CPI index used in Regulatory Accounts

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	123.8	126.7	128.0
At 31 March (year end)	109.8	113.5	118.1	122.2	125.6	127.7	127.6
At 31 August	109.7	111.4	114.9	120.1	123.1	126.4	128.3

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

UK Air Traffic Services						
Calendar Year	Service Units		Total Service Units		Flights	
	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	9,475	10,325	9,608	2,342	2,153
2013	10,493	9,625	10,667	9,755	2,400	2,154
2014	10,860	9,858	11,035	9,979	2,469	2,212

### 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.

Oceanic		
Financial Year	Flights (000s)	
	CAA assumption	Actual
2011/12	399.5	402.5
2012/13	410.2	393.3
2013/14	421.1	402.8
2014/15	433.0	420.0

### Notes:

1. Oceanic flights are actual chargeable flights.

## 10 SCHEDULES OF COSTS EXEMPT FROM COST SHARING

The costs below represent costs exempt from cost sharing per Article 14 of the Charging Regulation 391/2013 that, in the view of the Directors, are to be carried forward from RP1 into the following Reference Period (RP2).

The amounts relate to UKATS and are stated in calendar year outturn prices.

### Defined Benefit Pension cost variance

<b>Pension Costs - UKATS</b>			
<b>Calendar Year - Outturn Prices</b>	<b>Actual reported</b>		<b>Estimate - unaudited</b>
	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>£ million</b>			
CAA Assumption	92.6	92.4	74.2
Actual	91.1	92.2	91.2
Variance	1.5	0.1	(17.1)
Cumulative Variance	1.5	1.7	(15.4)
<b>Allocated to:</b>			
Controllable			(2.3)
Uncontrollable			17.7
Total:			<u>15.4</u>

### Notes:

For the calendar years 2012 to 2014, the European Charging Regulation 391/2013, (the "Regulation"), dated 9 May 2013, Article 14.2 applied to costs exempt from traffic risk sharing for amounts relating to Eurocontrol charges. Legal opinion was sought by NERL, and accepted by the CAA and UK Department for Transport, which confirmed that the Regulation overrides the relevant content in the NERL Licence effective from 1 January 2014.

In addition the European Commission has provided guidance in this area and has instructed a working group on Economic Aspects to provide a report on the details of how the cost exempt from traffic risk sharing should be calculated. The work of this group is unlikely to be finalised until after the summer of 2015, but a guidance note has been produced together with an EC legal opinion supporting it. However, the DfT has concluded that neither the advice note nor the EC legal opinion is consistent with legal advice obtained by each of NERL and CAA and it has responded to the publication of the guidance note with commentary, supported by legal advice obtained by NERL, to highlight this inconsistency. Therefore NERL is inserting its best estimate of the value for pensions in the RAB for 2014, to be consistent with the CAA's advice about the appropriate approach for completing the CRCO returns under the Regulation. This is based on the Draft Guidance issued by the working group on 8 May 2015, to the extent it is consistent with the legal opinion obtained by NERL.

NERL's best estimate for the cost exempt amount for the RP 1 period is £17.7m on a UKATS basis.

1. Defined Pension costs variances reflect the cash variance between the CAA assumption included in RP1 determined costs and actual cash costs, including

contributions to the deficit repair fund and are specifically allowed for within Article 14.2 (a) (i) of the Charging regulation 391/2013.

2. Variances arise from inflationary impacts on pay awards and headcount. Variances for 2014 arise from changes in market conditions which have required the continuation of deficit repair contributions, which CAA's CP3 forecast assumed would cease in 2014. The variance in the table above reflects NERL's best estimate of the uncontrollable amounts which are to be carried forward.
3. NERL has implemented measures to reduce the impact of cost and risk of the defined benefit schemes. This includes closing the scheme to new members with effect from 1 April 2009, and amending the annual increase in pensionable pay.

### Spectrum costs variance

Spectrum Costs - UKATS Calendar Year - Outturn Prices £ million	Actual reported		Estimate - unaudited
	2012	2013	2014
	CAA Assumption	0.3	0.3
Actual	0.4	(0.3)	0.2
Variance	(0.1)	0.6	0.0
Cumulative Variance before adj	(0.1)	0.5	0.5

1. Spectrum cost variances reflect the cash variance between the CAA assumptions included in RP1 determined costs and actual cash costs. They arise due to the uncertainty surrounding the impact of the UK Government requirement to sell further spectrum frequencies for commercial use. These impact both radio and primary radars.
2. They are covered under Article 14.2 (a) (iii), "unforeseen new cost items not covered in the performance plan, but required by law".
3. During RP1 NERL has completed a radar modifications programme.
4. NERL has implemented measures to reduce the impact of this cost. The cost of radar modifications has been capitalised in line with IFRS accounting treatment (less any grants received), and the radio spectrum costs only relate to external costs paid to Government.

END OF REPORT