

# Proposal to modify Condition 6 (regulatory accounting requirements) of NATS (En Route) plc air traffic service licence: For consultation

CAP 1816



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## Chapter 1

# Introduction and background

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## Purpose of this document

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- 1.1 This document invites representations on a proposal to modify the requirements on NATS (En Route) plc (NERL) regarding the provision of regulatory accounts. The proposal is to change the wording of the audit statement that NERL is required to provide. The proposal is being made because guidance by the Institute of Chartered Accountants in England and Wales (ICAEW)<sup>1</sup> means that NERL's auditors will no longer be able to provide the current audit statement. The proposal will also formalise that the CAA may require NERL's auditors to carry out Agreed Upon Procedures (AUPs) on aspects of its regulatory accounts. AUPs will be agreed between the CAA, NERL and its auditors.
- 1.1 Under section 11(1) of the Transport Act 2000 (the Act) the CAA may modify the conditions of a licence if its holder consents to the modifications. NERL, as the licence holder, has agreed in principle to the modifications proposed in this document.
- 1.2 Under sections 11(2) and (3) of the Act before making modifications to a licence the CAA must publish a notice setting out the proposed modifications, their effect and the reasons for the proposal. The CAA must also state the period (of not less than 28 days) within which representations may be made regarding the proposed modifications. This document constitutes such a notice.

## Views invited

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- 1.3 Any representations on the proposals in this document should be sent by e-mail to [economicregulation@caa.co.uk](mailto:economicregulation@caa.co.uk) by 22 July 2019.
- 1.4 We expect to publish the representations on our website for other interested parties to read after the period for written representations expires. Any material that is regarded as confidential should be clearly marked as such. Please note that we have powers and duties with respect to information under Section 102 of the Act and the Freedom of Information Act 2000.
- 1.5 If you have any questions on this document please contact Rod Gander at [rod.gander@caa.co.uk](mailto:rod.gander@caa.co.uk).

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<sup>1</sup> Reporting to regulators on Regulatory Accounts (TECH 02/16 AAF).

## Next steps

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- 1.6 Once we have considered the representations, we will decide what modifications, if any, to make to NERL's licence. We will publish notice of our decision.

## Chapter 2

## Licence modification proposals

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- 2.1 Condition 6 of NERL's licence requires it to produce regulatory accounts each year which:
- enable the CAA and public to assess NERL's financial position and the financial performance of its UK Air Traffic Services and En route (Oceanic) businesses on a consistent basis distinct from each other and its affiliate or related undertakings;
  - assist the CAA to assess NERL's compliance with the licence;
  - assist the CAA and the public to assess performance against the assumptions underlying the current price control; and
  - inform future price control reviews.
- 2.2 NERL has to draw up in consultation with the CAA, and implement in a form approved by the CAA, regulatory accounting guidelines (RAGs) governing the format and content of its regulatory accounts.
- 2.3 The current wording in Condition 6(6)(a) of NERL's licence requires it to procure a report from its auditors stating whether in their opinion the regulatory accounts have been properly prepared in accordance with the Condition and the RAGs and on that basis fairly present the financial performance of NERL's UK Air Traffic Services and En route (Oceanic) businesses and NERL's financial position.
- 2.4 In its guidance ICAEW sets out that financial accounts prepared under the Companies Act are prepared under a fair presentation financial reporting framework such as IFRS and UK GAAP. However, regulatory accounts are not prepared on the basis of a fair presentation financial reporting framework and, therefore, do not necessarily represent a true and fair view of the financial performance or financial position of a company. This means that auditors will not be able to provide an opinion on a fairly presents or true and fair basis on NERL's regulatory accounts as required under Condition 6(6)(a).
- 2.5 The CAA is proposing, therefore, to remove the requirement for a fairly presents audit opinion from NERL's licence. As ICAEW guidance on the exact form of the audit opinion can change, we are not proposing to specify the exact wording of the audit opinion, but to include provision that the opinion should be in a form required by professional bodies that prescribe the form of audit reports for regulatory accounts, and should reference compliance with the licence condition and the RAGs. ICAEW says that an opinion on regulatory accounts would

provide reasonable assurance that they are free from material misstatement, whether due to fraud or error, and the auditors would obtain sufficient and appropriate audit evidence to provide a basis for the opinion. However, the assurance is not as strong as that provided by a fairly presents audit opinion.

- 2.6 The CAA is proposing to include a requirement for NERL to make reasonable endeavours to agree with the CAA and NERL's auditors AUPs designed to provide factual findings in the regulatory accounts. The AUPs will need to be relevant to the fulfilment of the CAA's duties under section 2 of the Act and proportionate to any concerns of the CAA in respect of its fulfilment of those duties. The proposed modification specifically mentions cost allocation between NERL's separate businesses and cross-subsidy as areas for which the CAA may require AUPs. However, AUPs will not be limited to these areas, as long as they are reasonable, proportionate and relevant to the CAA's duties. We consider that the provision for AUPs would mitigate the loss of assurance from the loss of a fairly presents audit opinion, in that it would allow us to consider elements of NERL's business specific to its economic regulation that may not be scrutinised to the same extent in the audit of NERL's statutory accounts.
- 2.7 We have proposed a similar removal of a fairly presents audit requirement and the addition of provision for AUPs for Heathrow Airport Limited's regulatory accounts<sup>2</sup>. This approach has also been used in other regulated sectors, for example energy.
- 2.8 The effects of our proposals would be to enable NERL to obtain an audit opinion on its regulatory accounts that would be compliant with its licence and to enable greater scrutiny to be given to aspects of NERL's business that are pertinent to NERL's business and may not be considered in such depth in its statutory accounts.
- 2.9 The reason for the proposed modification is that revised ICAEW guidance has meant that NERL can no longer obtain an audit opinion for its regulatory accounts in the form required currently in Condition 6.
- 2.10 The proposed licence modifications are in Appendix A.

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<sup>2</sup> 'CAP1769 - Economic regulation at Heathrow Airport from January 2020: proposals for interim arrangements', paragraph 6.25.

**APPENDIX A****Proposed modifications to Condition 6**

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**Condition 6**

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## 6. The Licensee shall:

- (a) procure, in respect of the regulatory accounts prepared in accordance with paragraph 4 in respect of a regulatory year, a report by the Auditors addressed to the CAA which provides their opinion on those accounts. The opinion should be worded in the form required by those professional bodies accountable for prescribing the form of audit reports on regulatory accounts and should reference compliance with the Condition and the Regulatory Accounting Guidelines; [stating whether in their opinion those accounts have been properly prepared in accordance with this Condition and the Regulatory Accounting Guidelines and on that basis fairly present the financial performance of the UK Air Traffic Services Business and the En route (Oceanic) Business, and the financial position of the licensee;]
- (b) deliver to the CAA the Auditors' report referred to in sub-paragraph (a) and the regulatory accounts referred to in paragraph 4 as soon as reasonably practicable, and in any event not later than seven months after the end of the regulatory year to which they relate; and
- (c) arrange for copies of the regulatory accounts and Auditors' report referred to in sub-paragraphs (a) and (b), respectively, to be made publicly available.

7. The licensee shall also:

- (a) make reasonable endeavours to secure agreement between itself, the CAA and the Auditors on Agreed Upon Procedures which are designed to provide the CAA with factual findings, where, from time to time, the CAA reasonably considers such procedures are relevant to the fulfilment of its duties and proportionate to any concerns of the CAA in respect of its fulfilment of those duties, in each case relating to the following:
  - i. the appropriateness of any amounts referred to in paragraphs 5(b)(i) and 5(b)(ii) of this Condition;
  - ii. the Licensee's compliance with the prohibition of cross-subsidies in paragraph 1 of Condition 9; and
  - iii. any other aspect of the regulatory accounts on which the CAA reasonably considers it requires factual findings.
- (b) procure, as required from time to time by the CAA, in respect of the regulatory accounts prepared in accordance with paragraph 4, a report by the Auditors



addressed to the CAA which states that they have carried out Agreed Upon Procedures and which sets out their findings.

8. The regulatory year of the Licensee shall run from 1 January to 31 December unless otherwise agreed with the CAA.
9. In this Condition:

**“Regulatory Accounting Guidelines”**

means the guidelines drawn up in accordance with paragraph 2 of this Condition.

**“UK Air Traffic Services Business”**

means the Licensee’s business other than the En route (Oceanic) Business.

Agreed Upon Procedures

means procedures which are from time to time agreed between the CAA, the Auditors and the Licensee and which the Auditors carry out and report on factual findings.