

# NESTA Annual Report and Accounts 2006/07

# NESTA Annual Report 2006/07

National Lottery Act 1998

Annual Report of the National Endowment for Science, Technology and the Arts for 2006/07, prepared pursuant to section 22[1] of the National Lottery Act 1998. Accounts of the National Endowment for Science, Technology and the Arts for the year ended 31 March 2007, prepared pursuant to section 23[1] of the National Lottery Act 1998, together with the Report of the Comptroller and Auditor General thereon.

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# NESTA Annual Report 2006/07

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# NESTA Annual Report 2006/07

## Jonathan Kestenbaum



At NESTA, we have a vision: of a vibrant UK leading the world in the application of knowledge, enterprise and creativity.

We believe that innovation – the successful exploitation of new ideas – is a national priority. Today and increasingly in the future, economic success and social progress will depend greatly on a country's ability to bring new ideas to market and to find innovative solutions to urgent social and environmental challenges.

This annual report outlines the significant progress NESTA has made during 2006/07 in its role as the leading agent for stimulating innovation in the UK. During the year, we completed the extensive review of our programmes that was started in 2005/06, and launched important initiatives in all our areas of activity.

NESTA works across the three areas of innovation – human, financial and policy – that together create the conditions in which innovation in the UK can flourish. Specifically, our programmes and activities are designed to:

- build a more pervasive culture of innovation in the UK;
- provide effective access to early-stage capital; and
- drive forward innovation research, and closely link it to the creation of outstanding innovation policy.

NESTA's Innovation Programmes (see page 6), which we reviewed and developed during 2006 and began to roll out in 2007, focuses on the first of these areas, working in partnership to find the best ways to foster the human aspects of innovation.

The emphasis is on piloting and testing different models and partnerships that can be replicated and scaled up by others.

NESTA Investments (see page 9), which launched in early 2007, focuses on the financial dimension. It is a new £50 million Fund to support innovative, early-stage businesses in the ICT, healthcare, technology and environmental technology sectors. By testing different investment models, it aims to demonstrate the viability of early-stage investment to third parties, showing how public funds can work in partnership effectively with their private sector counterparts.

Finally, NESTA's Policy & Research Unit (see page 10), which applies its expertise to inform debate and help shape innovation policy and practice, had a very busy year during 2006/07. Its ambitious programme of research, debate, networking events and activities reinforced NESTA's role as a hub for the innovation policy community.

NESTA is committed to stimulating and fostering innovation in the UK for both economic and social benefit. In 2007/08 we will continue to increase our levels of activity, launch new programmes, deepen our knowledge of what drives innovation and use that understanding to help create a strong and supportive policy climate in the UK for innovation.

I would like to take this opportunity to thank all staff, trustees and committee members for their hard work and commitment during the year. I look forward to another exciting, challenging year with great anticipation.

**Jonathan Kestenbaum**  
Chief Executive

## Chris Powell

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This has been a year of good progress for NESTA. We successfully completed a period of major internal restructuring, which has led to new programmes, expert committees and strengthened teams. In November 2006 we moved to our new offices in Plough Place in London – a truly inspiring space, which is already recognised as a physical hub for individuals and organisations to meet, swap ideas and network.

NESTA's statutory aims are to support and promote talent, innovation and creativity in the fields of science, technology and the arts. We have a clear strategy for achieving this:

- by establishing NESTA as a renowned centre of expertise that enriches the UK's understanding of innovation;
- by improving the UK's climate for innovation; and
- by testing and disseminating effective models of support for innovators.

There are good indications that NESTA's widely varied stakeholders are beginning to engage closely with our more focused agenda, and in 2006/07 we started to see the benefits of this. At our highly successful Annual Event in October 2006, which attracted more than 1,000 people, I was particularly encouraged to hear so many people talking knowledgeably about NESTA's ambitions and about issues concerning UK innovation. It was the first in a series of events that I believe have substantially raised NESTA's profile and visibility this year.

NESTA exists to find the most effective ways of encouraging talent and innovation for national benefit. This year we've laid the groundwork for considerable future success, and it is a year that I believe we can look back on with immense pride.

**Chris Powell**  
**Chairman**

## NESTA Innovation Programmes

**NESTA Innovation Programmes focuses on the human capacity for innovation – exploring the skills, collaborations, incentives and supporting infrastructure that underpin successful innovation. During the year, we began to pilot and develop models that others can replicate and scale up. We also started establishing a series of powerful partnerships with organisations that have the expertise and reach to help us achieve our ambitions.**

Innovation Programmes is made up of four components – Innovation Challenges, Creative Pioneers, NESTA Connect and Future Innovators – which together support NESTA's strategic goal of building a more pervasive culture of innovation in the UK.

### Innovation Challenges

In March 2007 we launched NESTA's Innovation Challenges, which focuses on social innovation. It delivers experimental projects that test the best ways of stimulating innovation in response to major social issues such as long-term chronic disease, and climate change. We look for partners from a wide range of sources, and particularly seek ideas that can be successfully scaled up from the local to the national level.

We also announced our first Challenge, focused on health innovation, and our first two partnerships. The NESTA-Young Foundation *Health Innovation Accelerator (HIA)* is delivered in partnership with the Young Foundation, a leader in the field of social innovation. *HIA* is a new model for speeding up the creation and development of social ventures in the health sector.

*Innovations in Mental Health* is a partnership with the Mental Health Foundation, Mental Health Media, Mind, Rethink and the Sainsbury Centre for Mental Health. We seek ideas from frontline workers, carers and people with direct experience of mental distress. The project aims to encourage fresh thinking about effective interventions in mental health. It looks for local ideas that, with the right support and guidance, have the potential to grow successfully into national projects with real impact.

In 2006/07 we also planned our second Challenge, which focuses on the environment and climate change, and launches in the summer of 2007.

### Plans for 2007/08

#### Continue to develop the Health Challenge

The NESTA-Young Foundation *Health Innovation*

*Accelerator's* 'call for ideas' goes live in Autumn 2007. During 2007/08 HIA will take selected ideas and develop them into new ventures, with the help of seed funding from NESTA and other partners. Its aim is to prototype, test and evaluate a new method of accelerating innovative social ventures.

In addition, we plan to explore other areas of health innovation, for example the challenges that arise from an ageing population.

#### Launch the Environment Challenge

Our second major Challenge will launch in the summer of 2007 and will support a cluster of projects relating to the environment and climate change. We are particularly interested in innovative approaches to encouraging behavioural change around these important issues.

### Creative Pioneers

During 2006/07 we developed NESTA's Creative Pioneers programme, providing business support to help unlock the commercial potential of exceptional cultural and creative entrepreneurs. We worked with partners across the UK to provide business training, early-stage funding, mentoring and expertise.

We supported our existing portfolio of 48 companies, all of whom received start-up grants of up to £35,000 through the Creative Pioneer Academy, supplemented by four years of business support and access to a budget that pays for mentoring/consultancy or coaching depending on the businesses' needs. The learning from The Academy and our portfolio fed into our newer initiatives, Starter for 6 and Insight Out.

Starter for 6 launched in November 2006. It is a three-year initiative that provides business skills training and start-up grants for budding entrepreneurs in Scotland, and is delivered with a range of partners and sponsors: Scottish Arts Council, Highlands and Islands Enterprise, Six Cities Design Festival, Cultural Enterprise Office, 4Talent and the Innovators Counselling Advisory Service for Scotland.

In its first year, Starter for 6 supported 63 entrepreneurs, working across a range of disciplines in science, technology and the creative industries.

Insight Out is a programme of enterprise training developed specifically for creative individuals, delivered in partnership with creative industry support agencies, regional development agencies and higher education institutions across the UK. The programme launched in 2004, and this year rolled out its activities across two new regions and nations in the UK: Wales and the South West. The programme now currently runs in seven nations and regions across the UK. It has supported a total of 56 individuals this year.

In December 2006 we announced an Intellectual Property Accelerator that helps creative entrepreneurs make the most of their intellectual property. The IP Accelerator focuses on the strategic importance and management of intellectual property, and we piloted it with participants from our Creative Pioneer Programme and with NESTA Investments companies.

#### Plans for 2007/08

##### **Continue to test and roll out business development techniques for early-stage creative businesses**

For example, through our Starter for 6 programme we intend to support up to 20 entrepreneurs from each of our Starter for 6 regions: Aberdeen, Dundee, Edinburgh, Glasgow, Inverness and Stirling. We will also provide professional development for individuals engaged in delivering business advice to creative industry start-ups, and pilot a Business Advisor Training Programme.

##### **Develop effective models of support for innovators, to encourage growth in the creative industries**

Commercial success is inhibited by infrastructural weaknesses (including access to finance and appropriate business advice, for example) and a lack of relevant skills. To help address this, NESTA will identify and introduce tools and resources which help young businesses grow. Through these activities we aim to support the policy priorities of the UK's Nations and to deliver components of the DCMS-led Creative Economy Programme.

## NESTA Connect

In 2006/07 we developed NESTA Connect, a new programme that generates insights into the innovation process by testing unexpected or extreme collaborations, which blur the boundaries between disciplines, organisations and places.

#### Plans for 2007/08

##### **Launch and develop NESTA Connect**

NESTA Connect formally launches in June 2007. We aim to establish a portfolio of partnership projects exploring themes of: interdisciplinary research, corporate open innovation, and building innovation communities on- and off-line.

##### **Crucible 2007**

Crucible targets early-career researchers and focuses on interdisciplinary collaboration. Piloted over recent years, Crucible 2007 will be extended to 30 talented industrial and academic researchers from across science, technology, engineering, maths and social sciences. Crucible is enabling NESTA to investigate and understand the barriers to interdisciplinary collaboration in research, and to develop a model of how the university and research infrastructure could more effectively support such work. Crucible's three residential weekend 'laboratories' run from July to December 2007, supporting up to 30 postdoctoral researchers. We aim to establish Crucible as a model for interdisciplinary networking and development, and to influence policy on nurturing interdisciplinary innovation.

##### **Pilot an Interdisciplinary Incubator at Design London Incubator**

Working in partnership with Imperial College, Tanaka Business School and the Royal College of Art, this project will deliver an interdisciplinary incubation space and resources for designers, engineers and business graduates to develop collaborative business proposals. The Design London Incubator is part of the Design London Programme, which is funded by the Higher Education Funding Council England.

## Future Innovators

In 2006/07 we set up Future Innovators, a programme that develops skills and attitudes for innovation among young people – self-belief, a spirit of enquiry and resourcefulness, for example,

or critical thinking, decision-making and the confidence to challenge received wisdom.

The programme works in partnership with the professionals and institutions that work with young people, testing new approaches and disseminating ideas and resources about education for innovation.

We began a programme of events and competitions for young people, based on experiential learning and engaging approaches. In the Planet SciCast competition, for example, young people make and upload short films about 'real science'. The networking events, run as part of Enterprise Week and National Science and Engineering Week, brought together young people, entrepreneurs, educators and scientists.

Planet Science is now part of our Future Innovators team. The number of visits to the Planet Science website (<http://www.planet-science.com>) increased by 36 per cent between November 2005 and March 2007, as we added new features based on experiential learning – for example, *Get Outside* aimed at younger children, science-themed *Party Time* for parents, and *Hands On Real Science* for teachers.

Future Innovators also supported the rollout of a number of successful models previously supported by NESTA's Learning Programme. The ICT Youth Challenge – a competition developed in Highlands and Islands, Scotland, which challenged teams of young people to develop an IT product or service – was rolled out across the north east of England (and will be introduced to other regions in 2007/08). Dreamlab Learning delivered a successful pilot in Northern Ireland that tested the benefits (and obstacles) of involving creative industries professionals in classroom environments. The findings are being disseminated to schools in England.

Ignite! has been spun out from NESTA and is now an independent organisation delivering creativity workshops for young people and teachers across the UK.

## Plans for 2007/08

### Formally launch Future Innovators

To accompany the launch (in April 2007), we are publishing a new study commissioned from Demos about young people's attitudes to work, careers and skills for innovation.

### Build our portfolio of pilot projects, to test new models

In 2007/08 we will implement our *Taking a Leap* pilot, which focuses on approaches that develop an informed understanding of risk among young people. Future pilots will explore different themes – all focused on testing scaleable approaches to building the skills and attitudes necessary for innovation.

### Build our portfolio of strategic partnerships, to implement successful approaches

For example, we are partnering with Enterprise Insight to develop the *Lowestoft Energy Challenge*, a pilot project to encourage enterprise capabilities in young people. Our aim is to make the pilot available to schools across the UK as a useful model for young person-led enterprise education.

### Develop our programme of events and competitions

We will continue our programme of events and competitions for young people, and plan to launch a major new competition around science, technology and innovation.

## NESTA Investments

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During 2006/07 we restructured and refocused our investment team, recruiting new members of staff with venture capital backgrounds, and developing our investments strategy. As a consequence, we launched our new Fund, NESTA Investments, on 8 March 2007, overseen by a highly experienced investment committee that includes leading private venture experts.

NESTA invests in seed or early-stage funds, either as a limited partner or co-investor. A key objective is to demonstrate the viability of early-stage investment to third parties. We aim to bring a commercial ethos to the way in which public funds are invested and to create more of a partnership approach between public funds and their private counterparts.

NESTA Investments operates through two arms: NESTA Ventures and NESTA Capital.

### NESTA Ventures

NESTA Ventures invests directly (on its own, or with partners) into innovative businesses, attracting significant co-investment and helping to turn their ideas or inventions into successful products and services. The overall objective of the fund is to demonstrate that commercial returns can be made through early-stage institutional investment.

Last year we completed eleven follow-on investments, and made eight new direct investments, in a wide range of innovative technology businesses. Light Blue Optics, for example is developing a pocket-sized projection unit that can be attached, or inserted into, mp3 players, mobile phones and laptops. Surface Generation has created a reconfigurable Pin Tooling technology to reduce time and cost to market for large components, and Plasma Clean develops and manufactures air cleansing systems, which can convert microbes, odours and volatile organic compounds into harmless by-products.

In addition to financial input, companies received ongoing mentoring and business support from NESTA and our partners to maximise the potential of the business and attract further rounds of funding. NESTA has one of the largest pools of mentors in the country.

### NESTA Capital

NESTA Capital invests in funds managed by others seeking to operate in seed/early-stage investing. We expect to be a strategic partner to a number of funds over the next five years.

NESTA Capital aims to demonstrate successful, replicable models (or combinations of models) in order to increase knowledge and confidence in the seed sector, leading to an increase in the amount of capital and business support available to potentially successful early-stage companies.

The first fund supported by NESTA Capital this year was the UMIP Premier Fund, managed by MTI Partners, which focuses on the 'late seed' model of investment, investing primarily in technology propositions spinning out from the University of Manchester.

### Plans for 2007/08

#### **Invest in the most promising businesses in the early-stage sector**

We aim to achieve this through investing around £6 million in direct investments, and through partnerships with other organisations. We will continue to support the best-performing companies in our existing portfolio, by completing a number of follow-on transactions, maintaining a high ratio of third-party, follow-on investment.

#### **Revise our business support offering for our portfolio companies**

Our aim is to provide the most effective services available to our existing portfolio of over 40 active businesses, as well as the dozen new deals we hope to source, to accelerate the growth of early-stage companies. The lessons learned from these methods will in turn be disseminated.

## NESTA Policy & Research Unit

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During 2006/07 we restructured and re-launched the NESTA Policy & Research Unit (NPRU). The new team unites NESTA's practical experience with deep understanding of the innovation policy and research environment.

NPRU's ambition is to be an intellectual catalyst for UK innovation. During 2006/07, it successfully laid the groundwork for achieving this, by focusing on:

- building a relevant and coherent policy and research programme that resonates with the UK's priorities;
- integrating policy goals with all NESTA programmes, using research to design programmes, and using the evidence base created by programmes to drive policy development; and
- establishing NESTA as a hub for a newly-invigorated policy and research community around innovation, particularly acting as a bridge between traditionally dispersed communities.

Over the course of the year, we completed recruitment for the new team, developed strong relationships with key influencers around the UK, and launched an ambitious programme of research.

In October 2006, for example, we launched *The Innovation Gap: why policy needs to reflect the reality of innovation in the UK*. This report suggested that the real innovation gap lies not between the UK and its competitors, but between the reality of innovation and how we measure it. Because policy is frequently constructed to 'correct' perceived deficits, the report's conclusions have had profound implications for the way in which the UK develops its innovation policy. The agenda laid out in *The Innovation Gap* is being further developed in NPRU's 'hidden innovation' strand of research.

We also launched a new series of 'Provocations' – extended essays by leading thinkers on innovation, which aim to foster debate and showcase thought-

provoking work. Our first two Provocations were by Charles Leadbeater (*The Ten Habits of Mass Innovation*) and Luke Georghiou (*Demanding Innovation: Lead markets, public procurement and innovation*). Both were launched at our regular policy breakfasts, which, since December 2006, have become important discussion and networking events for policymakers and other important stakeholders in the innovation debate.

Over the course of the year, we published nine policy briefings, covering a range of subjects from innovation in UK cities, innovative entrepreneurship in the UK and the link between innovation and the arts, through to responses to the Government's Gowers Review on intellectual property, and the Leitch Report on education and skills. These gained media attention, and improved NESTA's standing as both a resource and a leader of the innovation debate.

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### Plans for 2007/08

#### Three substantive areas of focus

We will concentrate most of our activities on hidden innovation (including innovation in services and user-led innovation), the role of 'place' in innovation, and the arts and innovation. To achieve this we will continue to commission and conduct new research, engage fully with all levels of Government, publish policy briefings, Provocations and responses to Government papers, and develop our growing innovation network.

We aim to further increase our policy presence and knowledge of innovation across the UK by recruiting a network of Innovation Policy and Research Fellows. Over the course of 2007/08, we aim to build on the achievements of the past year to secure NESTA's role as a home for, and an important voice in, any aspect of the UK's innovation policy debate.

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#### Finding out more

If you are interested in NESTA's work, visit [www.nesta.org.uk](http://www.nesta.org.uk) for more information about our programmes, investments and research.

## Investments and awards over £100,000 made during 2006/07

### Investments

Cardiak	£196,154
Cellcentric Ltd	£100,000
Cytox	£150,000
Incentec	£150,000
Light Blue Optics	£224,997
MMIC Solutions Ltd	£120,000
Plasma Clean Ltd	£150,000
Quotient Diagnostics	£117,000
Starbridge Systems Ltd	£130,000
Surface Generation Limited	£125,000
Symetrica Limited	£124,500

### Awards

Tapestry Partnership Ltd/Music and the Mind	£199,995
The Open University and Bristol University/Search	£200,000
The Young Foundation - Health Innovation Accelerator	£784,176
Discover/Listening To Learn	£165,434
Enterprise Accelerator	£150,000
Enterprise Gateway	£199,858
Glasgow Museums and Galleries/Rethinking Disability	£120,000
North Edinburgh Arts Centre/Starcatchers	£199,000
North East BIC Big Ideas	£187,427
Potteries Museum and Art Gallery/Talking to the Animals	£119,263
St Mary's University/The Leonardo Effect	£191,489

## Directors' Report and Commentary

### Constitution

NESTA – the National Endowment for Science, Technology and the Arts – was set up by the National Lottery Act, receiving Royal Assent on 2 July 1998. The composition of the Board and the Executive Team is given below.

The National Lottery Act 1998 and the Financial Directions, issued by the Secretary of State at the Department for Culture, Media and Sport (DCMS) under the National Lottery Act 1998, govern NESTA's operations. NESTA prepares its Accounts in accordance with the Accounts Directions issued by the Secretary of State. A copy of the Accounts Directions can be obtained by writing to NESTA's Chief Financial Officer.

### Statutory Objects

The statutory objects of NESTA are to support and promote talent, innovation and creativity in the fields of science, technology and the arts.

The objects of NESTA are to be achieved by the following means, namely:

- helping talented individuals (or groups of such individuals) in the fields of science, technology and the arts to achieve their potential;
- helping persons to turn inventions or ideas in the fields of science, technology and the arts into products or services:
  - which can be effectively exploited; and
  - the rights to which can be adequately protected; and
- contributing to public knowledge and appreciation of science, technology and the arts.

### Overview of developments

In 2007 NESTA established the programme streams and developed the organisational structure needed to support our ambition to transform the UK's capacity for innovation. We launched NESTA's Innovation Programmes and developed four major programme strands: NESTA Connect; Innovation Challenges; Future Innovators; and Creative Pioneers. We announced our first Challenge, focused on health innovation, and our first

major partnership, with the Young Foundation. A revitalised Crucible initiative opened for application in March. We rolled out our business training initiative for creative individuals, Insight Out, across new nations and regions, developing a model which others can adopt and apply. We also launched a pilot scheme to support entrepreneurs across Scotland, called Starter for 6, which in its first year worked with a total of 63 young businesses.

During the year we refocused and restructured our investments team, launched a new Fund in March and continued to support our existing investments portfolio (making eleven follow-on investments and eight new direct investments). We announced the first fund supported through NESTA Capital - the UMIP Premier Fund.

Finally, we completed the recruitment for our Policy & Research Unit, launching an ambitious programme of research (see page 10), and established NESTA as a hub for the policy and research community around innovation, through a series of policy breakfasts and publications.

### Financial overview

The Accounts on pages 23 to 25 show the income, expenditure and surplus for the year. These are summarised in the graph below with comparative figures for previous years.

A large proportion of the year under review focused on the restructuring of the organisation and realignment of programme streams. In particular, this involved the closure of some programmes to new applications, extensive consultation and discussion around the development of NESTA's new strategic direction, and assessments of the organisational structure and personnel needed to support it. As a result, there was a period of relatively low programme activity, although this started to pick up again in the final quarter as new programme streams were launched. As anticipated in last year's report, overall spending at £21m was slightly below the previous year after allowance for expenditure at NESTA Futurelab, which was spun off at the end of 2006. The build-up in programme activity is expected to see a significant increase in 2008 to a projected £32m.

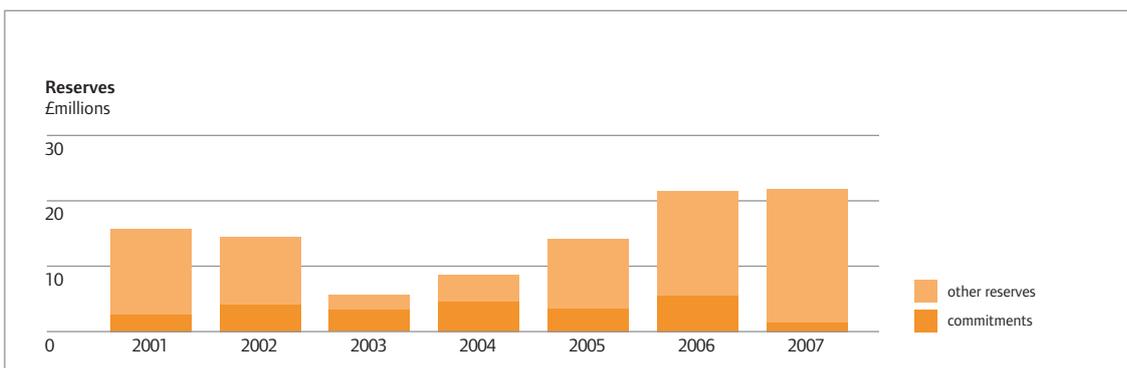
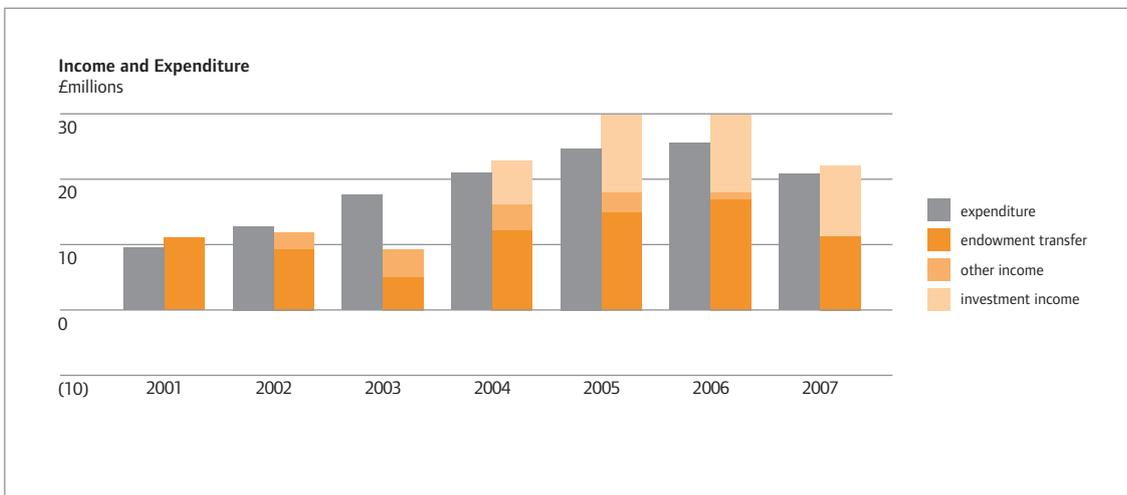
The ratio of corporate services costs to continuing non-exceptional expenditure remained fairly constant at 13%. With corporate services cost savings starting to come through, and the development of programme activity, the ratio is projected to fall below 8% in 2008.

Investment income is primarily interest on the Endowment, including any surplus income. Total Endowment and other assets at 31 March 2007 were £308m. Of this, £285m is the Endowment, invested in gilts and cash. Other investments are held in UK equity and property funds. It should be noted that the last four years have seen good investment returns due to strong UK equity and property markets. Falling interest rates boosted reported returns on UK government bonds until 2006, but this effect went into reverse in 2007.

As can be seen from the Income and Expenditure graph below, NESTA's investment income is both variable and insufficient to cover its expenditure,

requiring the drawdown of capital from the Endowment. The recent additional funding of £75m over the five years from 2006 provides sufficient resources to maintain and grow activities until 2011. In order to reduce the gap between investment income and expenditure and to allow for cost inflation, NESTA is reviewing the investment strategy for its Endowment with the DCMS and HM Treasury. It is also actively pursuing development of partnership working and co-funding of projects, extending its successful record of co-investment with private and other public sector funds, and seeking to realise financial returns from its more successful investments and projects.

NESTA maintains reserves to cover commitments made but not yet contracted (soft commitments) and also to provide for fluctuations in investment income. Set out below in the Reserves graph is a summary of soft commitments and available reserves over recent years.



### Organisational Structure

Chris Powell	Chairman
Jonathan Kestenbaum	Chief Executive and Accounting Officer

In addition to the Chief Executive, the following were members of the Executive Team during the period from the start of the year to the date of this report:

Name	Date appointed	Date resigned	Position
Helen Gresty	May 2006		Executive Director Innovation Programmes
Richard Halkett	June 2006		Executive Director Policy & Research
Tom Hawkins	July 2004	April 2007	Chief Financial Officer
David Hunter	June 2006		MD NESTA Investments
Angela Salt	June 2006	March 2007	Executive Director Corporate Communication

The following were Trustees during the period from the start of the year to the date of this report:

Name	Date appointed	Date retired	Committee membership
Chris Powell (Chairman)	October 2003		Investment (Chair)
Sir Michael Barber	February 2006		Innovation Programmes (Chair)
Professor Marc Clements	July 2006		Investment
Dr Stuart Cosgrove	October 2004		
Sherry Coutu	May 2006		Investment
Andrew Flanagan	February 2006		Finance & Audit (Chair)
Professor Julia Goodfellow	January 2005		
Dr Tracy Long	December 2003		Innovation Programmes, Finance & Audit
Patrick McKenna	January 2007		Innovation Programmes
Professor William Morris	January 2004		
Graham Ross Russell	November 2001		Finance & Audit
Prue Skene	January 2006	February 2007	
Professor Kathy Sykes	January 2007		

The following were non-Trustee members of Committees during the period from the start of the year to the date of this report:

Name	Date appointed	Date retired	Committee
William Roe	August 2006		Innovation Programmes
David Auckland	August 2006		Innovation Programmes
Paul Roberts	July 2006		Innovation Programmes
Tom Hadfield	August 2006		Innovation Programmes
Rowena Young	August 2006	December 2006	Innovation Programmes
Ernie Richardson*	November 2006		Investment
Adrian Beecroft	December 2006		Investment
Ian McIsaac	November 2006		Investment

As part of NESTA's new strategy development and restructuring, the Invention & Innovation, Fellowship and Learning Committees were dissolved in June 2006. At the same time, the new Innovation Programmes and NESTA Investments Committees were established.

\* Ernie Richardson stood down from the Investment Committee in December 2006, due to a potential conflict of interest, but was subsequently reinstated in April 2007.

### Creditors

It is NESTA's policy to abide by the DTI's "Better Payment Practice Code" and in particular to pay bills in accordance with contract terms. For the year ended 31 March 2007, 85% of undisputed invoices were paid within 30 days or the contractual term (2006: 85%).

### Equal Opportunities

NESTA is committed to a policy of equal opportunity in its employment practices. In particular it aims to ensure that no actual or potential employee or awardee receives more or less favourable treatment on the grounds of race, colour, ethnic or national origin, marital status, age, gender, sexual orientation, disability, religious beliefs, political beliefs, economic status or class.

### Employee Consultation

NESTA ensures that there are arrangements to promote effective consultation and communication with all staff. Meetings of all staff are held periodically at which matters relating to NESTA's activities are discussed and staff are briefed on matters discussed at the Executive Team, Committee and Trustee meetings.

### Post Balance Sheet Events

There are no material post balance sheet events.

### Other Matters

NESTA maintains a register of interests of members of the Board of Trustees and staff which is available for public inspection by appointment at NESTA's principal office.

NESTA's staff received gifts and hospitality totalling £126 (2005: £324) during the financial year.

NESTA's staff gave gifts totalling £2,258 (2005: £195) during the financial year.

### Audit Information

All necessary audit information has been disclosed to the auditors.

## Remuneration Report

### Remuneration Committee

The Remuneration Committee is a committee of the Board of Trustees and is incorporated into the Finance and Audit Committee. It consists of non-executive Trustees whose appointment and term is agreed by Trustees.

The Remuneration Committee was chaired by Daniel Alexander QC until 30 June 2006 and by Andrew Flanagan thereafter. Other members of the Remuneration Committee were Dr Tracy Long and Graham Ross Russell. A secretariat function is provided by the Chief Financial Officer, and the Chief Executive, Chief Financial Officer and HR Director normally attend. The Remuneration Committee met three times during the year.

The Remuneration Committee's role is to:

- agree a proforma employment contract and subsequent changes;
- agree a remuneration and benefit policy including pension provision which will attract, retain and motivate staff;
- agree the terms, conditions and salary levels for all Executive posts and any annual award to staff;
- review any related party transactions of Trustees and staff; and

- hear Executive level disciplinary appeals.

The Remuneration Committee has begun to develop a long-term framework for performance-related pay following a partial introduction in 2007. This work is ongoing.

### Chairman, Trustees' and Committee Members' Remuneration

NESTA's Chairman, Trustees and Committee Members were entitled to the following remuneration:

- The Chairman is paid a salary of £25,310 (2006: £24,814) for two days per week.
- Trustees are paid an allowance of £208 (2006: £202) per day spent on NESTA business.
- Committee Members are paid an allowance of £167 (2006: £163) per day.
- Out-of-pocket expenses are recoverable.

For a list of all Trustees and Committee Members, refer to the Directors' Report and Commentary. Each Trustee and Committee Member, with the exception of the Chairman, was paid between £0 and £5,000 in each applicable year.

### Audited information:

#### Executive Team Remuneration

The salary and allowances for the Executive team were as follows:

	Salary & Benefits 2007 £'000	Bonus Payments 2007 £'000	Total 2007 £'000	Salary & Benefits 2006 £'000	Bonus Payments 2006 £'000	Total 2006 £'000	Employment Start Date	Employment End Date	Notice Period
Jonathan Kestenbaum	124	24	148	60	5	65	01/11/2005	-	6 mths
Helen Gresty	74	6	80	-	-	-	01/06/2004	-	6 mths
Richard Halkett	58	8	66	-	-	-	22/06/2006	-	6 mths
Tom Hawkins	95 <sup>1</sup>	9	104	91	-	91	19/07/2004	06/04/2007	6 mths
David Hunter	87	21	108	-	-	-	05/06/2006	-	6 mths
Janet Morrison	120 <sup>2</sup>	10	130	90	-	90	01/03/1999	31/07/2006	6 mths
Angela Salt	126 <sup>3</sup>	-	126	-	-	-	06/06/2006	31/03/2007	6 mths

- Benefits represent cash payments made under NESTA's flexible benefits scheme. They include childcare subsidy, enhanced benefits (health, learning and science, technology and arts related memberships) and pension/holiday flex.
- No member of the Executive team received any non-cash benefits (benefits in kind).
- All Executive appointments are on a permanent basis.

The pension entitlements of members of the Executive Team were:

	Real increase in pension at 60 £'000	Total accrued pension at 60 £'000	CETV at 31 March 2007 £'000	CETV at 31 March 2006 £'000	Real increase in CETV in year £'000
Janet Morrison	2	9	44	33	11

CETV is the cash equivalent transfer value.

Jonathan Kestenbaum, Helen Gresty, Richard Halkett, Tom Hawkins, David Hunter and Angela Salt were not members of the defined benefit pension scheme, but were entitled to a contribution to a personal pension or group defined contribution scheme at a rate of 12% of salary.

**Jonathan Kestenbaum**  
Accounting Officer  
12 July 2007

1 Where a member of staff's last day of service falls in the next financial year, any payments in lieu of notice or ex gratia payments will be disclosed in the 2007/08 Remuneration Report.

2 Includes an amount for payment in lieu of notice and a contractual payment of £50k.

3 Includes an amount for payment in lieu of notice.

## Statement of Accounting Officer's Responsibilities

### Accounting Officer's responsibilities

Under the National Lottery Act 1998, the Secretary of State for Culture, Media and Sport has directed NESTA to prepare for each financial year a statement of accounts in the form and on the basis set out in the Accounts Directions. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of NESTA and of its income and expenditure, recognised gains and losses and cash flows for the financial year.

In preparing the accounts, the Accounting Officer is required to comply with the requirements of the *Government Financial Reporting Manual* and in particular to:

- observe the Accounts Directions issued by the Secretary of State for Culture, Media and Sport, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards as set out in the *Government Financial Reporting*

*Manual* have been followed, and disclose and explain any material departures in the financial statements; and

- prepare the financial statements on a going concern basis.

The Accounting Officer of Department for Culture, Media and Sport has designated the Chief Executive as Accounting Officer of NESTA. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding NESTA's assets, are set out in the Non-Departmental Public Bodies' Accounting Officers' Memorandum issued by HM Treasury and published in *Government Accounting* and in the *Financial Directions* issued by the Secretary of State for Culture, Media and Sport under Section 21 of the National Lottery Act 1998.

**Jonathan Kestenbaum**  
Accounting Officer  
12 July 2007

## Statement on Internal Control

### Scope of responsibility

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of NESTA's policies, aims and objectives, whilst safeguarding the public funds and assets for which I am personally responsible, in accordance with the responsibilities assigned to me in *Government Accounting* and ensuring compliance with the requirements of NESTA's Management Statement and Statement of Financial Requirements. I am accountable to the Secretary of State for Culture, Media and Sport and to Parliament for ensuring that NESTA distributes its funds with due regularity and propriety, and to the Board of Trustees for the economic, efficient and effective use and control of the funds.

The Chairman of the Board of Trustees has the responsibility for satisfying the Board that a sound

system of internal control is maintained within NESTA.

### The purpose of the system of internal control

The system of internal control is designed to manage risk to a reasonable level (rather than to eliminate all risk of failure) to achieve NESTA's policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of NESTA's policies, aims and objectives, to evaluate the likelihood of those risks materialising and their consequent impact, and to manage them efficiently, and with appropriate and proportionate controls. The system of internal control has been significantly reviewed and refreshed in accordance with Treasury guidance in the year ended 31 March 2007 and the

revised risk management framework was operational at the date of approval of the Annual Report and Accounts.

### Capacity to handle risk

Under NESTA's Risk Management Framework, NESTA's Finance & Audit Committee is responsible for monitoring compliance with the Risk Management Framework and for reviewing and reporting to the Board of Trustees annually on the approach to risk management. NESTA's approach to risk management is designed with regard to best practice, in particular reflects "Management of Risk – Principles and Concepts" (the "Orange Book") issued by HM Treasury and related publications.

NESTA maintains two risk registers – one for emergent risks and one for managed risks. The former identifies and swiftly addresses new risks and ongoing risks where the controls are no longer effective. This is reviewed quarterly by the Executive team, and the Finance and Audit Committee. The latter focuses on reviewing the controls for known, regular risks where the probability of risk materialisation is not high, and on ensuring there is no change in circumstance or context that requires a particular risk to be escalated.

The Executive Team regularly reviews strategic and reputational risks, and individual members of the Executive Team are responsible for managing and monitoring these and other operational risks, where appropriate through their teams. Certain operational risks relating to defined projects are documented in separate risk registers, and the identification and control of risk is increasingly seen as a management tool that involves a wide cadre of staff, and is applied in a number of operational circumstances.

### The risk and control framework

The key elements of NESTA's risk management strategy and control framework are set out below:

- The Trustees consider that the nature of NESTA's remit is one that requires an element of risk-taking in its activities if it is to succeed. Accordingly, the Trustees have agreed a risk appetite that is summarised as one of regular risk identification and monitoring, and managed risk-taking rather than risk aversion. This includes recognition that some activities or projects may fail to a greater or lesser extent and that such failures can be an important source of learning.
- The framework defines the categories of, and approach to, risk and incorporates guidance from Financial Directions issued by the Secretary of State under the National Lottery Act 1998, Government Accounting and other official sources.
- Risk management is incorporated into NESTA's strategic and business planning processes.
- A budget and budget monitoring system is set within the context of a multi-year Strategic Plan. The budget is approved by the Board of Trustees and regular reports on financial and operational performance are made to the Finance & Audit Committee and Trustees.
- A Risk Management Framework sets out the basis for identifying, evaluating, allocating, monitoring and reporting on risk in the context of the agreed risk appetite. Central to this is the maintenance of risk registers which are updated throughout the year as a result of executive and management reviews and workshops. These registers show the potential impact and likelihood of risks, their source, consequences, agreed actions and responsibilities for management. Under this model, emergent risks are reported to and discussed by the Trustees, following analysis of emergent and managed risk by the Finance & Audit Committee.
- NESTA maintains a number of operational policies, grouped around governance, financial controls, and workplace management. These policies are supported by public accountability training and compliance inductions, designed to ensure that NESTA staff are aware of the principles regulating their conduct in these areas, and comply with the Nolan principles of public life. There is special focus on the effective procurement of goods and services, the management of conflicts of interest and the control of fraud and misuse of public funds. Detailed guidelines support these NESTA policies.
- NESTA has an internal audit service which operates in accordance with Government Internal Audit Standards. The annual internal

audit plans are informed by the risk register, are endorsed by the Finance & Audit Committee and approved by the Accounting Officer. The internal auditors provide an annual report on internal audit activity, an independent opinion on the adequacy and effectiveness of NESTA's system of internal control and recommendations for improvement. All internal audit reports and reviews are considered by the Finance & Audit Committee. Management responses and progress against agreed actions are reported to and monitored by the Finance & Audit Committee on a quarterly basis with an annual review of all outstanding matters.

#### **Review of effectiveness by the Accounting Officer**

My review of the effectiveness of the system of internal control is informed by the work of internal auditors and the executive managers within NESTA who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I have been advised on the implications of the results of my review by the Board and the Finance and Audit Committee and a plan to address weaknesses and ensure continuous improvement of the system is in place.

I have reviewed the various registers, reports and plans forming part of the risk and control framework and considered the practical application of the reviews and other required actions of the Executive

Team, Finance & Audit Committee and Trustees in relation to risk management and internal control. In particular, this review has included the Emergent Risk register covering key organisational risks, the review of the risk registers by the Executive team and the monitoring reports to the Finance & Audit Committee and the annual report on risk management and internal controls of the Chair of the Finance & Audit Committee to the full Board of Trustees. I have reviewed the work and reports of the Internal Auditors and the system of monitoring the implementation of agreed actions arising from their recommendations, including in particular the annual report of the Internal Auditors to the Finance & Audit Committee, the responses to their recommendations and their opinion of the effectiveness of NESTA's system of internal control.

I have reviewed the system of internal control and satisfied myself as to its soundness.

#### **Significant internal control problems**

I have concluded that, although improvements to systems can always be made and NESTA has an ongoing programme to continuously improve the scope and effectiveness of its systems, there have been no significant internal control problems during the year.

**Jonathan Kestenbaum**  
Accounting Officer  
12 July 2007

#### **Review of effectiveness by the Chairman**

My review was informed by the annual report of the Finance & Audit Committee on risk management and control.

On behalf of the Board of Trustees, I have reviewed the system of internal control and satisfied myself as to its soundness.

**Chris Powell**  
Chairman  
12 July 2007

# Certificate and Report of the Comptroller and Auditor General to the Houses of Parliament and the Scottish Parliament

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I certify that I have audited the financial statements of the National Endowment for Science, Technology and the Arts (NESTA) for the year ended 31 March 2007 under the National Lottery Act 1998. These comprise the Income and Expenditure Account, the Balance Sheet, the Cashflow Statement and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

## **Respective responsibilities of the Trustees, Chief Executive and auditor**

The Trustees and Chief Executive as Accounting Officer are responsible for preparing the Annual Report, the Remuneration Report and the financial statements in accordance with the National Lottery Act 1998 and directions made thereunder by the Secretary of State for Culture, Media and Sport, with the consent of HM Treasury, and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of the Accounting Officer's Responsibilities.

My responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the National Lottery Act 1998 and directions made thereunder. I report to you if, in my opinion, certain information given in the Annual Report, which includes a Management Commentary and Remuneration Report, is consistent with the financial statements. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

In addition, I report to you if NESTA has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by HM Treasury regarding remuneration and other transactions is not disclosed.

I review whether the Statement on Internal Control reflects NESTA's compliance with HM Treasury's guidance, and I report if it does not. I am not required to consider whether this statement covers all risks and controls, or form an opinion on the effectiveness of NESTA's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

## **Basis of audit opinion**

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Trustees and Chief Executive in the preparation of the financial statements, and of whether the accounting policies are most appropriate to NESTA's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free

from material misstatement, whether caused by fraud or error and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

### Opinions

#### Audit Opinion

In my opinion:

- the financial statements give a true and fair view, in accordance with the National Lottery Act 1998 and directions made thereunder by the Secretary of State for Culture, Media and Sport, with the consent of HM Treasury, of the state of NESTA's affairs as at 31 March 2007 and of its surplus for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with the National Lottery Act 1998 and directions made thereunder by the Secretary of State for Culture, Media and Sport, with the consent of HM Treasury; and
- information given in the Annual Report, which includes a Management Commentary and Remuneration Report, is consistent with the financial statements.

#### Audit Opinion on Regularity

In my opinion, in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

### Report

I have no observations to make on these financial statements.

**John Bourn**  
**Comptroller and Auditor General**  
**16 July 2007**

National Audit Office  
 157-197 Buckingham Palace Road  
 Victoria  
 London  
 SW1W 9SP

## Income and Expenditure Account

### For the year ended 31 March 2007

	Notes	Total 2007 £'000	Continuing operations 2006 £'000	Discontinued operations 2006 £'000	Total 2006 £'000
<b>Income</b>					
Investment returns: Endowment	3	12,671	12,309	-	12,309
Adjustment to market value	3	(4,068)	861	-	861
		<b>8,603</b>	<b>13,170</b>	-	<b>13,170</b>
Investment returns: Other	3	2,738	3,963	86	4,049
Drawdown from Endowment	4	10,398	14,445	-	14,445
Other income	5	248	349	1,143	1,492
<b>Total income</b>		<b>21,987</b>	<b>31,927</b>	<b>1,229</b>	<b>33,156</b>
<b>Expenditure</b>					
Innovation Programmes	7	9,171	12,037	2,431	14,468
NESTA Investments	7	3,824	4,635	0	4,635
Policy & Research	7	1,273	977	0	977
Communications, events and public affairs	7	3,439	1,867	0	1,867
<b>Direct Support of Objectives</b>		<b>17,707</b>	<b>19,516</b>	<b>2,431</b>	<b>21,947</b>
Corporate Services	7	2,824	2,696	0	2,696
Exceptional Costs	7	0	768	0	768
<b>Total expenditure</b>		<b>20,531</b>	<b>22,980</b>	<b>2,431</b>	<b>25,411</b>
Notional cost of capital		(4)	0	(18)	(18)
<b>Net surplus after notional costs</b>		<b>1,452</b>	<b>8,947</b>	<b>(1,220)</b>	<b>7,727</b>
Reversal of notional costs		4	0	18	18
<b>Surplus for the year</b>		<b>1,456</b>	<b>8,947</b>	<b>(1,202)</b>	<b>7,745</b>

There were no other gains or losses during the year.  
The notes on pages 26 to 43 form an integral part of these financial statements.

## Balance Sheet

### At 31 March 2007

	Notes	2007 £'000	2006 £'000
<b>Fixed assets</b>			
Tangible fixed assets	8	3,322	493
Investments: Endowment	9	250,000	250,000
		<b>253,322</b>	<b>250,493</b>
<b>Current assets</b>			
Investments: Endowment	9	34,905	34,802
other	9	23,289	20,766
Debtors	10	181	640
Cash at bank and in hand	18	431	873
		<b>58,806</b>	<b>57,081</b>
<b>Current liabilities</b>			
Creditors: awards falling due for payment within one year	11	4,904	5,354
other amounts falling due within one year	12	2,102	2,109
		<b>7,006</b>	<b>7,463</b>
<b>Net current assets</b>		<b>51,800</b>	<b>49,618</b>
<b>Total assets less current liabilities</b>		<b>305,122</b>	<b>300,111</b>
Creditors: awards falling due for payment after one year	11	724	1,552
Provisions and charges	13	9	228
<b>Net assets</b>		<b>304,389</b>	<b>298,331</b>
<b>Represented by reserves</b>			
Endowment reserve	19	281,134	276,532
Accumulated surplus	19	23,255	21,799
<b>Total reserves</b>		<b>304,389</b>	<b>298,331</b>

The financial statements, which comprise the income and expenditure account, the statement of total recognised gains and losses, the balance sheet, the cash flow statement and the related notes, were approved by the Board of Trustees on 26 June 2007 and signed on their behalf by:

**Jonathan Kestenbaum**  
Accounting Officer  
12 July 2007

The financial statements were authorised for issue on 16 July 2007.

The notes on pages 26 to 43 form an integral part of these financial statements.

## Cash flow statement

### For the year ended 31 March 2007

	Notes	2007 £'000	2006 £'000
<b>Net cash outflow from operating activities</b>			
Payments of awards		(8,204)	(9,939)
Payments for staff and trustees' costs		(6,293)	(5,489)
Payments for other costs		(6,564)	(9,364)
Project funding		123	1,820
Transfer of project funding to Futurelab Education		0	(2,578)
Donations received		0	85
Other income		115	440
	20	<b>(20,823)</b>	<b>(25,025)</b>
<b>Returns on investments</b>			
Interest and dividends received		<b>15,686</b>	<b>17,094</b>
<b>Capital expenditure and financial investment</b>			
Payments to acquire tangible fixed assets		(3,407)	(163)
Receipts from disposal of tangible fixed assets		37	16
Increase in Endowment		15,000	15,000
Net proceeds from the (purchase)/sale of investments		(32,338)	(44,948)
Decrease/(increase) in short term deposits		35,640	37,400
		<b>14,932</b>	<b>7,305</b>
<b>Increase/(decrease) in cash</b>	18	<b>9,795</b>	<b>(626)</b>

The notes on pages 26 to 43 form an integral part of these financial statements.

# Notes to the Accounts

## For the year ended 31 March 2007

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### 1 Accounting policies

#### Accounting convention

The accounts are prepared under the historical cost convention, modified to include, where relevant, the revaluation of tangible fixed assets by reference to current costs at the balance sheet date.

The accounts have been prepared in accordance with the Accounts Direction issued by the Secretary of State for Culture, Media and Sport (August 2002) with the consent of Treasury in accordance with Section 23 (2) of the National Lottery Act 1998, and so far as appropriate they meet the requirements of the Companies Act, Government Accounting and of the Statements of Standard Accounting Practice/Financial Reporting Standards issued and adopted by the Accounting Standards Board.

#### Income

Income is accounted for on a receivable basis in the year to which it relates.

Investment returns include interest, dividends and all realised and unrealised capital gains or losses.

Within the Endowment, most bonds are purchased under a policy of holding them to maturity. The return on such bonds is the gross interest receivable plus or minus the amortisation of any discount or premium to nominal (redemption) value. The amortisation is calculated on a straight-line basis over the remaining duration of the bond. Other fluctuations in the market value of bonds are also included in investment income.

#### Policy for recognition of donations

Goods donated to NESTA are recognised in the Income and Expenditure Statement on a received basis where goods are retained by NESTA to add value to operations or where NESTA acts as principal for resources which are transferred to third parties. Donations of goods are not recognised where NESTA acts solely as an agent in relation to the resources. Donations of services are recognised on receipt of services that add value to NESTA's operations, to the extent that a monetary value can be reliably attributed to the service.

In applying this policy the following considerations have been taken into account in determining where NESTA is acting as principal:

- whether NESTA applied for the grant of resources or donation which NESTA has then transferred to a third party;
- whether NESTA is able to direct how the donation should be used;
- whether NESTA owned the resources prior to transfer to a third party;
- whether NESTA accepts legal responsibility for the transfer of the donation to a third party.

Valuation is based on the lower of market value or the cost NESTA would have incurred to acquire the asset or service, net of any discounts.

#### Awards Expenditure

Awards made by NESTA are recognised in full in the Income and Expenditure Account and Balance Sheet on the date when a binding contract is signed or equivalent obligation created, even if conditional upon future events. Commitments or approvals to fund specific projects or other awards not yet contracted (soft commitments) are disclosed by way of note.

Award expenditure includes seed and early-stage investments made, which are not capitalised. Sales of such investments, or other returns from them, are separately accounted for as income as they arise.

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**Other Expenditure**

Other expenditure is recognised as services are performed or goods received.

**Investments**

Fixed and current asset investments are carried at market value at the Balance Sheet date.

The part of the Endowment that may not be expended within one year is treated as a fixed asset investment. The part of the Endowment that may be spent within one year and all other investments are treated as current asset investments.

Seed and early-stage investments made under the programmes are not capitalised. Note 9(b) gives details of such investments. In accordance with BVCA guidelines, portfolio companies are typically valued at cost. An uplift in valuation is accepted only at the point where there is significant investment from an institutional 3rd party investor. Valuations may be written down to account for the health status of the company, which is based on cash-flow and performance against plan.

**Tangible Fixed Assets**

Tangible fixed assets are capitalised in the balance sheet at their historic cost and, where necessary because of materiality, re-valued annually by reference to indices published by the Office of National Statistics.

Tangible fixed assets costing less than £500 are written off in the year of purchase.

**Depreciation**

Depreciation is provided on all tangible fixed assets. Depreciation is calculated on a straight line basis over the expected useful life of the assets as follows:

- Leasehold Improvements – over the life of the lease
- All other assets – three to five years

**Taxation**

The National Lottery Act 1998 provides for NESTA to be exempt from tax under the Income and Corporation Taxes Act 1988. The Inland Revenue has recognised this exemption. Accordingly, no taxation has been provided for in these financial statements.

**Value Added Tax**

Income and Expenditure is recorded net of VAT. Irrecoverable VAT is treated as a separate expenditure item, which, as with all costs applicable to the whole organisation, has been apportioned across the divisions.

**Pensions**

The costs of all employer pension contributions are charged to the Income and Expenditure Account. Certain employees are members of a defined benefit pension scheme. Because it is a multi-employer scheme, NESTA has insufficient information to estimate the actuarial valuation of this scheme and has therefore accounted for it as if it were a defined contribution scheme.

**Operating Leases**

Costs incurred under operating leases are taken into the Income and Expenditure Account in the period to which they relate.

**Notional Cost of Capital**

Notional cost of capital employed by NESTA is calculated as 3.5% (2006: 3.5%) of the average non-lottery funded balances employed over the financial year.

## Notes to the Accounts

### For the year ended 31 March 2007

#### 2 Continuing and discontinued operations

At the end of 2006, NESTA transferred the net assets and business of NESTA Futurelab to Futurelab Education, an independent charity.

In accordance with FRS3: Reporting Financial Performance, NESTA is required to report separately the results of continuing operations and discontinued operations to assist users to assess the financial performance of these aspects of the business's operations, and to form a basis for the assessment of future results. There was no income or expenditure relating to discontinued operations in 2007.

#### 3 Investment returns

	2007 £'000	2006 £'000
<b>Endowment:</b>		
Gross interest receivable	14,986	15,496
Amortisation of redemption (premium)/discount	(2,315)	(3,187)
	<b>12,671</b>	<b>12,309</b>
Adjustment to market value	(4,068)	861
<b>Total returns</b>	<b>8,603</b>	<b>13,170</b>
<b>Other investments:</b>		
Interest and dividends receivable	657	577
Capital gains	2,039	3,412
<b>Total returns</b>	<b>2,696</b>	<b>3,989</b>
Bank Interest	42	60
<b>Total investment returns</b>	<b>11,341</b>	<b>17,219</b>

#### Endowment

NESTA has a policy of buying government bonds and holding them to maturity within part of the Endowment. Such bonds have been purchased at a (premium)/discount to nominal value. This inevitably gives rise to a capital (loss)/profit on redemption, compensated for by higher/(lower) interest income. NESTA's policy is to amortise this (premium)/discount on a straight line basis over the remaining life of the bond.

Additional changes are caused purely by fluctuations in the market value of bonds. These are referred to as adjustments to market value. At 31 March 2007, cumulative losses due to adjustments to market value include £3,491k (2006: cumulative gains of £970k) that will reverse in future years.

As it is NESTA's policy to hold bonds to maturity, it is felt that investment returns, unadjusted by market value fluctuations, give a more meaningful indication of the income that NESTA may spend.

Included within amortisation of redemption premium and market value adjustment are realised capital

losses of £3,927k (2006: £2,669k). These losses were anticipated and are a natural consequence of NESTA's investment strategy.

#### Other investments

There were no realised capital gains or losses (2006: £0).

## 4 Transfer from Endowment

NESTA is permitted to draw down limited funding from its Endowment as set out in Note 19. The £10,398k transfer represents the amounts used in this way (2006: £14,445k). Spending rules applicable to the transfer from the Endowment mean that the first £10m of expenditure is covered from investment income, and by transfer from the Endowment thereafter. As a result, investment income actually received in excess of £10m will contribute to any surplus for the year.

## 5 Other income

	Total 2007 £'000	Continuing operations 2006 £'000	Discontinued operations 2006 £'000	Total 2006 £'000
Project funding: DfES	68	245	681	926
DTI	10	64	7	71
One North East RDA	40	33	-	33
Highlands & Islands Enterprise Funding	15	-	-	-
Royalty income, loan interest and dividends from awards	67	4	13	17
Other income	48	3	442	445
<b>Total other income</b>	<b>248</b>	<b>349</b>	<b>1,143</b>	<b>1,492</b>

Project funding is substantially matched against expenditure. Other income includes the provision of services, grants and sponsorship and recharges of expenses.

## Notes to the Accounts

### For the year ended 31 March 2007

#### 6 Staff costs

	2007 £'000	2006 £'000
Salaries and benefits	4,780	5,169
Social security costs	472	527
Pension contributions	377	518
	<b>5,629</b>	<b>6,214</b>
Trustees' remuneration	47	51
<b>Total staff costs</b>	<b>5,676</b>	<b>6,265</b>

Further information on pensions is included in Note 17 and in the Remuneration Report.

£1,061k of staff costs in 2006 related to discontinued operations (Futurelab).

Interest-free season ticket loans were available to all NESTA staff during the year. As at 31 March 2007, two senior managers and sixteen staff had taken up these loans. All loans are below £4,800. The value in aggregate of season ticket loans in excess of £2,500 is £5,432.

#### The full time equivalent number of persons employed during the year was as follows:

	Employees 2007	Agency/contract staff 2007	Staff on secondment 2007	Total 2007	Total 2006
Executive	6	0	0	6	4
Innovation Programmes	31	1	0	32	67
NESTA Investments	9	1	0	10	17
Policy & Research	6	1	0	7	5
Communication	15	1	0	16	14
Corporate Services	26	5	0	31	36
	<b>93</b>	<b>9</b>	<b>0</b>	<b>102</b>	<b>143</b>

Included within the 2006 total are 28 employees of NESTA Futurelab who left with the transfer of business at the end of 2006. See Note 2.

## 7 Expenditure

### 7(a) Expenditure by division

Expenditure has been classified by activity: programmes, investments, policy & research, communication and corporate services.

Programmes and activities now closed (for example our Invention and Innovation programme) are included within the appropriate division for the purposes of comparison.

#### **Innovation Programmes**

NESTA's Innovation Programmes focuses on the human capacity for innovation – finding the best ways to stimulate curiosity, creativity, inventiveness and enterprise.

Total expenditure for the year on continuing activities was £9,171k (2006: £12,037k).

#### **NESTA Investments**

NESTA Investments invests in start up companies and seed stage funds, either as a limited partner or co-investor, and aims to demonstrate the viability of early-stage investment. It operates through two arms: NESTA Ventures and NESTA Capital.

See Note 9(b) for details of active investments held.

Total expenditure for the year on continuing activities was £3,824k (2006: £4,635k).

#### **Policy & Research**

NESTA's Policy & Research Unit aims to be an intellectual catalyst for UK innovation, carrying out an ambitious programme of research, informing programme design and establishing NESTA as a hub for a newly invigorated community around innovation.

Total expenditure for the year on continuing activities was £1,273k (2006: £977k).

#### **Communications, events and public affairs**

Communications, events and public affairs have taken on an enlarged and more central role under NESTA's new strategic direction, mainly to support NESTA's ambition of establishing itself as a renowned and influential centre of expertise on UK innovation. Supporting and integrated with Innovation Programmes, NESTA Investments, and Policy & Research, the Communication division now works across a wide range of activities, including: corporate affairs; media and public affairs; regular high-level events to reinforce NESTA's role as a hub for the innovation community; branding; publications (corporate and marketing/publicity to support individual programmes); websites; competitions; and sponsorships.

Total expenditure for the year on continuing activities was £3,439k (2006: £1,867k).

#### **Corporate Services**

The Corporate Services division includes finance, human resources, information technology, property management, legal and compliance functions.

Total expenditure for the year on continuing activities was £2,824k (2006: £2,696k).

## Notes to the Accounts

### For the year ended 31 March 2007

#### 7(b) Expenditure by type

	2007 £'000	2006 £'000
Investments, grants and projects	9,758	12,540
Staff costs	5,676	5,205
Other staff related costs	1,018	918
Depreciation	452	521
Legal and audit fees	313	236
Operating leases: land and buildings	941	470
Other operating costs	2,373	2,322
<b>Total continuing and non-exceptional costs</b>	<b>20,531</b>	<b>22,212</b>
Futurelab	-	2,431
Redundancy costs	-	519
Payments in lieu of notice	-	249
<b>Total discontinued activities and exceptional costs</b>	<b>-</b>	<b>3,199</b>
<b>Total expenditure</b>	<b>20,531</b>	<b>25,411</b>

Investments, Grants and Projects are external costs relating to all activity directly supporting the core mission, including research projects, seminars, publication, investee and recipient training, mentoring, events, investments, training academies and grant activities.

Staff Costs include salaries, National Insurance, pension and benefit contributions. Other staff related costs include temporary and contract staff costs and training and development expenditure.

Other operating costs include all centrally administered costs, principally property costs (excluding rent which is disclosed separately) and irrecoverable VAT. It also includes other costs not centrally administered, principally travel and entertaining, consulting and other professional fees.

#### 7(c) Further information

	2007 £'000	2006 £'000
<b>Net surplus is stated after charging:</b>		
Auditor's remuneration	30	32
Staff travel, subsistence and hospitality	240	244
Trustee travel and subsistence	16	17

The auditor's remuneration was entirely for audit services.

## 8 Tangible fixed assets

	Leasehold improvement £'000	Computer hardware £'000	Computer software £'000	Office equipment £'000	Fixtures and fittings £'000	Assets under construction £'000	Total £'000
<b>Cost or valuation</b>							
At 1 April 2006	1,257	359	1,010	132	327	42	3,127
Additions	2,397	411	79	157	363	-	3,407
Disposals	(1,257)	(227)	-	(70)	(333)	-	(1,887)
<b>At 31 March 2007</b>	<b>2,397</b>	<b>543</b>	<b>1,089</b>	<b>219</b>	<b>357</b>	<b>42</b>	<b>4,647</b>
<b>Depreciation</b>							
At 1 April 2006	1,070	231	973	96	264	-	2,634
Charge for the year	208	124	36	34	50	-	452
Disposals in year	(1,195)	(226)	-	(50)	(290)	-	(1,761)
<b>At 31 March 2007</b>	<b>83</b>	<b>129</b>	<b>1,009</b>	<b>80</b>	<b>24</b>	<b>-</b>	<b>1,325</b>
<b>Net book value</b>							
<b>At 31 March 2007</b>	<b>2,314</b>	<b>414</b>	<b>80</b>	<b>139</b>	<b>333</b>	<b>42</b>	<b>3,322</b>
At 31 March 2006	187	128	37	36	63	42	493

Assets have not been revalued at 31 March 2007 as their current cost does not differ materially from the historic cost. There is no material difference between the net book values of assets on a current cost and on a historic cost basis.

Assets under construction relate to various information systems.

Additions in the year include VAT expected to be irrecoverable. Additions in previous years have not included a VAT element; however, a prior year adjustment has not been made, as the effect of such an adjustment would be immaterial.

## Notes to the Accounts

### For the year ended 31 March 2007

#### 9(a) Investments

NESTA has been provided with a permanent Endowment of £250,000k and further amounts which may be spent. The part of the Endowment which may not be drawn down within the next 12 months is treated as a fixed asset investment and the rest as a current asset investment.

NESTA invests the Endowment with the Commissioners for the Reduction of The National Debt in UK government bonds and deposits. Other funds including any surplus income from the Endowment are invested separately by commercial investment managers.

	Cost 2007 £'000	Market value 2007 £'000	Cost 2006 £'000	Market value 2006 £'000
Cash and short-term deposits	9,814	9,848	35,650	35,916
Government Stocks - Up to one year	110,543	104,052	44,231	41,043
Government Stocks - Two to five years	148,103	147,329	209,786	207,843
Government Stocks - Over five years	23,786	23,677	-	-
<b>Total Endowment</b>	<b>292,246</b>	<b>284,905</b>	<b>289,667</b>	<b>284,802</b>
Cash and short-term deposits	433	433	-	-
UK equities	13,441	16,023	13,444	14,805
Property funds	4,648	6,833	4,653	5,961
<b>Total other investments</b>	<b>18,522</b>	<b>23,289</b>	<b>18,097</b>	<b>20,766</b>
<b>Total investments</b>	<b>310,768</b>	<b>308,194</b>	<b>307,764</b>	<b>305,568</b>

Of the Endowment, £250,000k is treated as a fixed asset investment and £34,905k (2006: £34,802k) as a current asset investment. All other investments are treated as current asset investments.

	Endowment 2007 £'000	Other 2007 £'000	Total 2007 £'000	Endowment 2006 £'000	Other 2006 £'000	Total 2006 £'000
1 April 2006	284,802	20,766	305,568	281,132	17,047	298,179
Addition to Endowment	15,000	-	15,000	15,000	-	15,000
Investment returns	8,603	2,696	11,299	13,170	3,989	17,159
Transfer to cover expenditure	(23,500)	(173)	(23,673)	(24,500)	(270)	(24,770)
<b>31 March 2007</b>	<b>284,905</b>	<b>23,289</b>	<b>308,194</b>	<b>284,802</b>	<b>20,766</b>	<b>305,568</b>

## Note 9(b) Seed and Early-Stage Investments

NESTA Investments has made equity, participating or convertible loan or quasi-equity investments in a portfolio of early-stage and start-up companies. As part of NESTA's restructuring process in 2006, some investments made under previous programmes have been incorporated into the actively managed portfolio. A summary of the portfolio of investments held at 31st March 2007 is set out below:

Company	£'000
Symetrica Ltd	374
Quotient Diagnostics Ltd	341
MMIC Solutions Ltd	300
Ashe Morris Ltd	250
Surface Generation Ltd	250
AquaPharm Bio-Discovery Ltd	250
CellCentric Ltd	250
Advanced Transport Systems Ltd	250
Veryan Medical Ltd	245
Hypertag Ltd	238
NanoSight Ltd	225
Light Blue Optics Ltd	225
Tideway Systems Ltd	221
Scyron Ltd	200
Cardiak Ltd	196
Probe Scientific Ltd	194
Starbridge Systems Ltd	191
Haemostatix Ltd	160
Ceravision Ltd	155
CamFPD Ltd	150
Plasma Clean Ltd	150
Micrima Ltd	150
Meciria Ltd	150
St Andrews Fuel Cells Ltd	148
Spiral Gateway Ltd	145
Cytox Ltd	138
Dialog Devices Ltd	125
Orthogem Ltd	117
Odontis Ltd	110
ROBAT Ltd	105
Bluegnome Ltd	100
	<b>6,102</b>
Other investments of less than £100k	625
<b>Total investment at cost</b>	<b>6,727</b>
<b>Number of investments</b>	<b>41</b>

## Notes to the Accounts

### For the year ended 31 March 2007

Note: Cost figures relate to an investment made in return for an ownership stake (i.e. equity holding or convertible loan). Any transaction costs incurred by NESTA or management support costs are not included in these figures.

During the year 19 investments were made into new companies and existing portfolio companies at a total cost of £1.8m.

	Number	Cost £'000
Portfolio at 1 April 2006	51	6,561
Effect of portfolio restructuring	(18)	(1,605)
Investments transferred in from inactive management	0	0
Portfolio carried forward	33	4,956
New investments	8	940
Further investments to existing portfolio	11	831
<b>Portfolio at 31 March 2007</b>	<b>41</b>	<b>6,727</b>

Using valuation guidelines produced by the British Venture Capital Association (BVCA) and in line with best practice, NESTA estimates the value of this portfolio to be £6.4m as at 31 March 2007.

It should be noted that the majority of the companies are not at a stage of generating significant earnings or in many cases even revenues. Valuation of companies at this early stage of development is an inherently volatile and uncertain process. The valuation guidelines used take a conservative approach and are unlikely to represent the true value of some of the companies with significant potential.

BVCA guidelines provide for investments to be carried at cost unless there is information indicating an impairment or sufficiently clear evidence to support an increase in valuation. In practice, for these investments, an uplift in valuation is only accepted if there is significant investment from an institutional 3rd party investor in a subsequent round.

## 10 Debtors

	2007 £'000	2006 £'000
Debtors	107	394
Prepayments	63	170
Accrued income	11	76
<b>Total debtors</b>	<b>181</b>	<b>640</b>

NESTA is required to disclose the value of any debtor balances with other bodies within the Whole of Government Accounts (WGA) boundary. There were year-end balances held with other Central Government bodies (One North East, Big Lottery Fund and The Scottish Executive) of £12,724, (£10,000, £2,371 and £353 respectively), inclusive of VAT where applicable.

## 11 Creditors: awards

Contracted commitments	At 1 April 2006 £'000	New commitments £'000	Commitments paid £'000	De-commitments £'000	At 31 March 2007 £'000
Innovation programmes	6,149	4,911	(5,872)	(140)	5,048
NESTA Investments	757	2,222	(2,332)	(198)	449
Policy & Research	-	131	-	-	131
<b>Total</b>	<b>6,906</b>	<b>7,264</b>	<b>(8,204)</b>	<b>(338)</b>	<b>5,628</b>

Payments under contracted commitments are expected to be made as follows:

	Within 1 year £'000	1 to 2 years £'000	2 to 3 years £'000	3 to 4 years £'000	4 to 5 years £'000	Total £'000
Innovation Programmes	4,324	631	93	-	-	5,048
NESTA Investments	449	-	-	-	-	449
Policy & Research	131	-	-	-	-	131
<b>Total</b>	<b>4,904</b>	<b>631</b>	<b>93</b>	<b>0</b>	<b>0</b>	<b>5,628</b>

Awards committed or approved but not yet contracted are set out in Note 14.

## 12 Creditors: other amounts falling due within one year

	2007 £'000	2006 £'000
Trade creditors	227	333
Taxation and social security	152	164
Other creditors	3	1
Accruals and deferred income	1,720	1,611
<b>Total creditors</b>	<b>2,102</b>	<b>2,109</b>

NESTA is required to disclose the value of any year-end creditor balances with other bodies within the Whole of Government Accounts (WGA) boundary. There were year-end balances held with other Central Government bodies (Big Lottery Fund) of £77,557, inclusive of VAT.

## Notes to the Accounts

### For the year ended 31 March 2007

#### 13 Provisions and charges

Provisions for dilapidations on leasehold buildings	Fishmongers' Chambers 2007 £'000	St Magnus House 2007 £'000	Total 2007 £'000	Fishmongers' Chambers 2006 £'000	St Magnus House 2006 £'000	Total 2006 £'000
At 1 April 2006	148	80	228	85	35	120
Additional provision in year	7	-	7	63	45	108
Provision released in year	-	(69)	(69)	-	-	-
Utilisation of provision in year	(155)	(11)	(166)	-	-	-
<b>At 31 March 2007</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>148</b>	<b>80</b>	<b>228</b>

Provisions for bad debts	Trade Debtors 2007 £'000	Trade Debtors 2006 £'000
At 1 April 2006	-	-
Additional provision in year	9	-
Provision released in year	-	-
Utilisation of provision in year	-	-
<b>At 31 March 2007</b>	<b>9</b>	<b>0</b>

NESTA relocated from Fishmongers' Chambers and St Magnus House, to 1 Plough Place, in November 2006. Therefore, all provisions relating to these two properties have been used or released during the year. We are aware that the terms of the 1 Plough Place lease state that NESTA has a potential obligation relating to restoring the premises to the condition described in schedule 1 of said lease (at the landlord's discretion). However, as at the current period, it is not possible to reliably measure the costs (given the length of time remaining on the lease), or the probability of this clause being invoked. As such, whilst recognising the existence of a contingent liability, no provision has been made for 2007.

## 14 Awards committed or approved but not yet contracted

Awards committed or approved (soft commitments) are not treated as liabilities until contracted.

Soft commitments	At 1 April 2006 £'000	Approvals £'000	Contracted £'000	Cancelled/ Withdrawn £'000	At 31 March 2007 £'000
Innovation Programmes	2,862	2,538	(4,911)	(80)	409
NESTA Investments	2,281	4,753	(2,222)	(1,337)	3,475
Policy & Research	0	729	(131)	0	598
<b>Total</b>	<b>5,143</b>	<b>8,020</b>	<b>(7,264)</b>	<b>(1,417)</b>	<b>4,482</b>

Cancelled/withdrawn soft commitments attributed to NESTA Investments are in line with previous years (2006: £1,306k). Many of these commitments never reach the point of a formal, contracted hard commitment. Common reasons include: the breaking down of contract negotiations where NESTA and the company fail to agree final terms; the company accepting an offer from an alternative funding organisation; or the company failing to raise the additional funds required to complete a larger round.

## 15 Capital commitments

There are no amounts committed and contracted for in respect of capital expenditure.

## 16 Operating lease commitments

At 31 March 2007, NESTA had an annual commitment under operating leases as follows:

Land and Buildings	Less than 1 year to expiry	1 to 5 years to expiry	More than 5 years to expiry	2007 £'000	2006 £'000
Fishmongers' Chambers, London				-	113
St Magnus House, London				-	173
1 Plough Place, London			15 yrs 3 mths	709	0
Scotswood Road, Newcastle Upon Tyne		3 yrs 6 mths		5	5
West Bute Street, Cardiff	10 mths			6	0
Scion House, Stirling		1 yr 6 mths		10	0
<b>Other Leases</b>					
Photocopiers		4 yrs		19	19
<b>Total</b>				<b>749</b>	<b>310</b>

In addition to the premises mentioned above, NESTA maintains two regional offices on short term licences or by using serviced offices.

## Notes to the Accounts

### For the year ended 31 March 2007

#### 17 Pensions

NESTA is a member of the Pension Scheme for Administration and Technical Staff in the Arts ("PSATSITA"). The scheme is a multi-employer defined benefit scheme. NESTA has closed this scheme to new members and now offers employees the alternative of a 12% contribution, on a defined contribution basis, to a personal pension scheme or group stakeholder scheme. NESTA's total contribution made in respect of the period, for all schemes, totalled £377k, including outstanding contributions of £29k.

##### PSATSITA Scheme

The scheme is financed from payments by NESTA and employees into a trustee-administered fund independently managed and invested by a leading fund management company. The scheme is a defined benefit scheme. However, because it is a multi-employer scheme, NESTA is unable to identify its share of the underlying assets and liabilities. The scheme has therefore been accounted for as if it were a defined contribution scheme in accordance with FRS17: Retirement Benefits.

An Actuarial Valuation of the pension fund takes place every three years. The market value of the whole scheme assets at 31 March 2004 was £7,535k, representing 101% of the estimated liabilities of the scheme. The surplus or deficit on the scheme affects the size of contributions made by NESTA and its staff. These are currently 13.5% and 5.5% of pensionable earnings respectively.

The total annual pension is calculated as one-sixtieth of final pensionable earnings for each year of service and index linked to the Retail Prices Index, with a maximum increase of 5% per annum. On retirement three-eighths of the final pensionable earnings for each year of service may be taken as a lump sum.

Although the scheme was considered to be in surplus at its last actuarial valuation, NESTA considers that it has an unquantifiable contingent liability in respect of its membership of the PSATSITA scheme.

#### 18 Analysis of net cash

	2007 £'000	2006 £'000	Movement £'000
At bank and in hand	431	873	(442)
Included in investments	10,247	10	10,237
<b>Total</b>	<b>10,678</b>	<b>883</b>	<b>9,795</b>

## 19 Reserves

	Endowment reserve £'000	Accumulated Surplus £'000	Total £'000
At 1 April 2006	276,532	21,799	298,331
Transfer from Endowment	(10,398)	-	(10,398)
Addition to Endowment	15,000	-	15,000
Surplus for the year	-	1,456	1,456
<b>At 31 March 2007</b>	<b>281,134</b>	<b>23,255</b>	<b>304,389</b>

Up to £31,134k (2006: £26,532k) of the Endowment reserve can be transferred by NESTA to cover commitments (in excess of £10m per annum) made up to 31 March 2008.

## 20 Reconciliation of surplus for the year to net cash outflow from operating activities

	2007 £'000	2006 £'000
Surplus for the year	1,456	7,745
Drawdown from Endowment	(10,398)	(14,445)
Investment returns	(11,341)	(17,219)
Depreciation	452	593
Non cash grant of assets	-	76
(Increase)/decrease in debtors	459	311
Increase/(decrease) in awards contracted	(1,278)	(819)
(Decrease) in other creditors	(7)	(1,375)
Increase in provisions and charges	(166)	108
<b>Net cash outflow from operating activities</b>	<b>(20,823)</b>	<b>(25,025)</b>

## Notes to the Accounts

### For the year ended 31 March 2007

#### 21 Financial instruments

FRS13: Derivatives and Other Financial Instruments requires disclosure of the role which financial instruments have had during the period in creating or changing the risks which the Trustees of NESTA face in undertaking their role. NESTA does not currently use derivatives or other financial instruments, but does take key financial risks into consideration in setting investment and expenditure policies, in making investment choices and in managing its cash and treasury assets. The key relevant risks are set out below.

##### Liquidity Risks

In 2007, £11,341k (52%) of NESTA's income derived from the returns accruing on its investments. The remaining income derived from a transfer from its Endowment of £10,398k (47%), and project funding and other income of £248k (1%).

NESTA is satisfied that it has sufficient certainty over future income and liquid resources in the form of cash of £431k and current asset investments of £58,194k and is therefore not exposed to significant liquidity risks.

##### Interest Rate Risks

For the main part of its Endowment, NESTA has a policy of buying five-year gilts on a rolling basis and holding them until maturity. This policy reduces its economic exposure to short-term interest rate risks, although reported results may be volatile due to the policy of revaluing such investments to prevailing market prices. Medium to long term exposure to persistent changes in interest rates, in particular real rates after allowance for inflation, does pose potential risks to NESTA.

##### Interest Rate Profile

The following table shows the interest rate profile of NESTA's financial assets.

	Market value £'000	Weighted average interest rate %	Weighted average period for which rate is fixed
<b>At 31 March 2007</b>			
Fixed rate	272,610	5.38%	2 yrs 4 mths
Floating rate	10,678	5.23%	
Non-interest bearing assets	25,337		
	<b>308,625</b>		
<b>At 31 March 2006</b>			
Fixed rate	283,531	4.43%	2 yrs 0 mths
Floating rate	2,144	4.27%	
Non-interest bearing assets	20,766		
	<b>306,441</b>		

All assets are denominated in sterling. The book value equals the fair value for all assets held. Interest rates on bonds expected to be held to maturity are gross redemption yields and include expected capital gains or losses to redemption.

The assets on the left page are included in the Balance Sheet as:

	2007 £'000	2006 £'000
Fixed asset investments	250,000	250,000
Current asset investments	58,195	55,568
Cash at bank and in hand	431	873
<b>Total</b>	<b>308,625</b>	<b>306,441</b>

### Inflation Rate Risks

NESTA is exposed to cost inflation, particularly in relation to staff costs. At the same time, the majority of its Endowment is invested in fixed income gilts that do not provide any form of cover against changes in inflation. Whilst this is not considered a substantial risk to effective operations in the short term, assuming no substantial and unexpected increase in inflation, it does pose challenges to NESTA in the medium to longer term. NESTA is currently considering how the effective purchasing power of the Endowment can be better protected in future.

### Foreign Exchange and Credit Risks

NESTA is not exposed to any material foreign exchange or credit risks.

## 22 Special payments

As required by Government Accounting rules, NESTA is required to disclose special payments where they exceed £250k. During the year ended 31 March 2007, there were ten individual redundancy or compensation payments made for loss of office, the aggregate value being £258k.

## 23 Related parties

NESTA is an NDPB of the Department for Culture, Media and Sport. The Department for Culture, Media and Sport is regarded as a related party. During the year, NESTA has had material transactions with the Department, and with the Big Lottery Fund (BIG), for whom the Department is regarded as the parent Department.

In addition, NESTA has had material transactions with other Government Departments and other central Government bodies, namely: the Department for Education and Skills, the Department for Trade and Industry and the Commissioners for the Reduction of the National Debt.

The following related party transactions occurred during the period:

Organisation	Name	Relationship to recipient organisation	Transactions for the year £'000	Balance outstanding £'000
<b>Trustees of NESTA</b>				
Library House	Sherry Coutu	Director	49	-
<b>Committee members of NESTA</b>				
<b>Employees of NESTA</b>				

NESTA is satisfied that the above mentioned transaction was entered into in the ordinary course of business, and on arms-length terms.

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