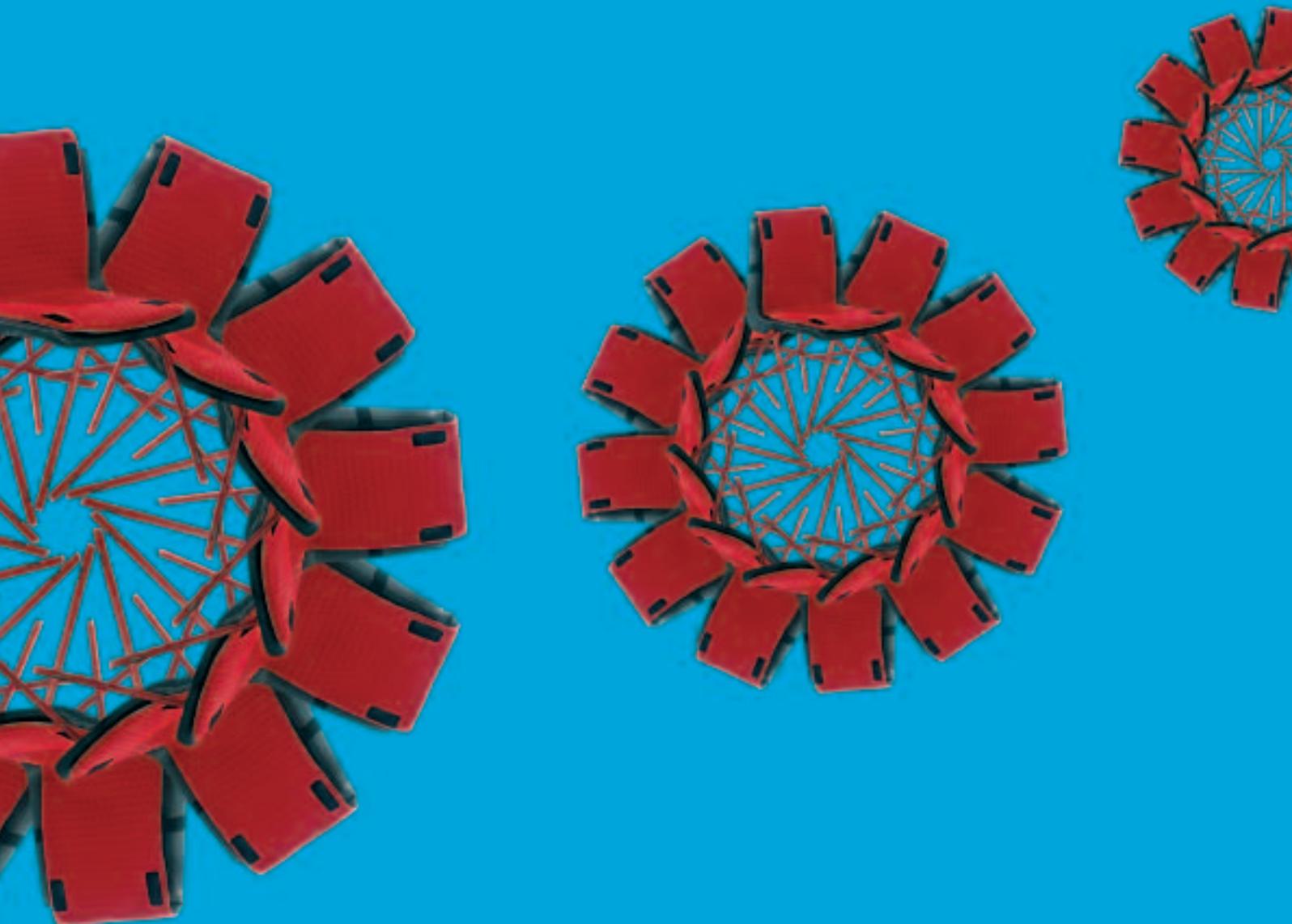
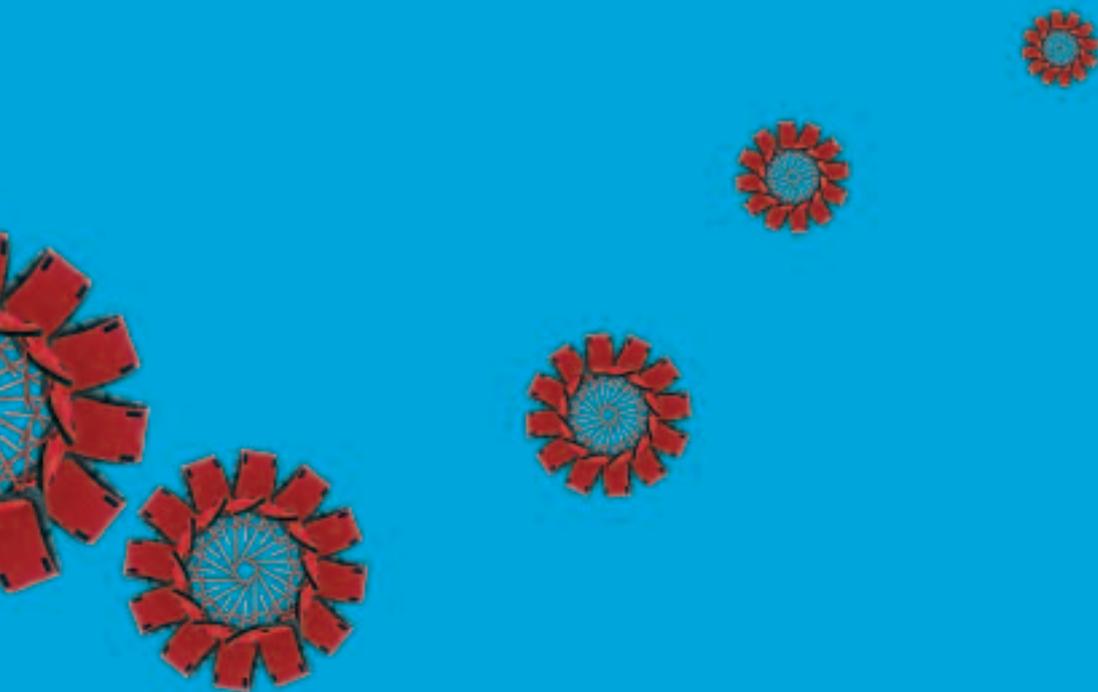


NESTA Annual Report and Accounts 2005/06
Transforming UK innovation





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National Lottery Act 1998

Annual Report of the National Endowment for Science, Technology and the Arts for 2005/2006, 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 2006, prepared pursuant to section 23[1] of the National Lottery Act 1998, together with the Report of the Comptroller and Auditor General thereon.

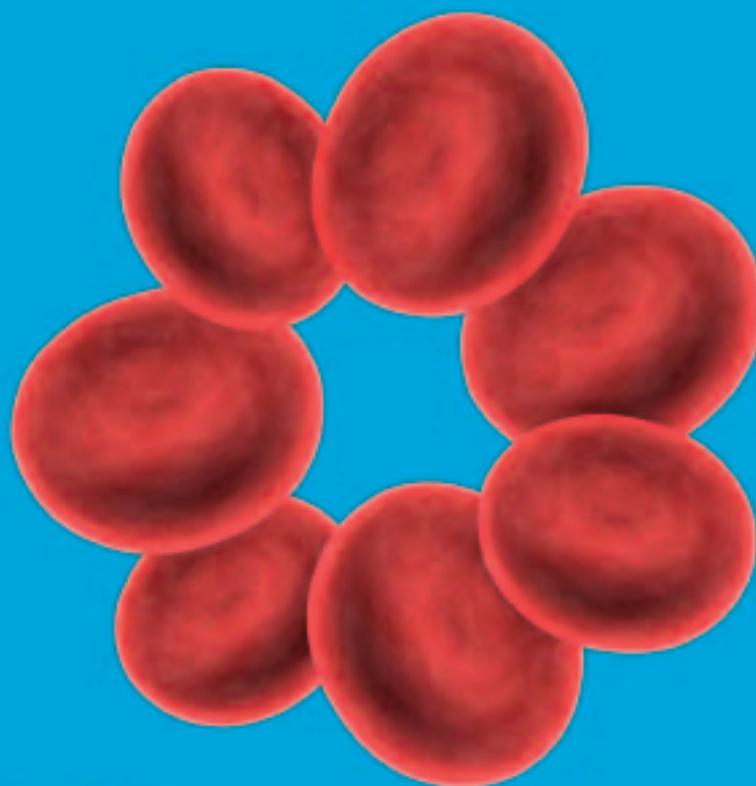
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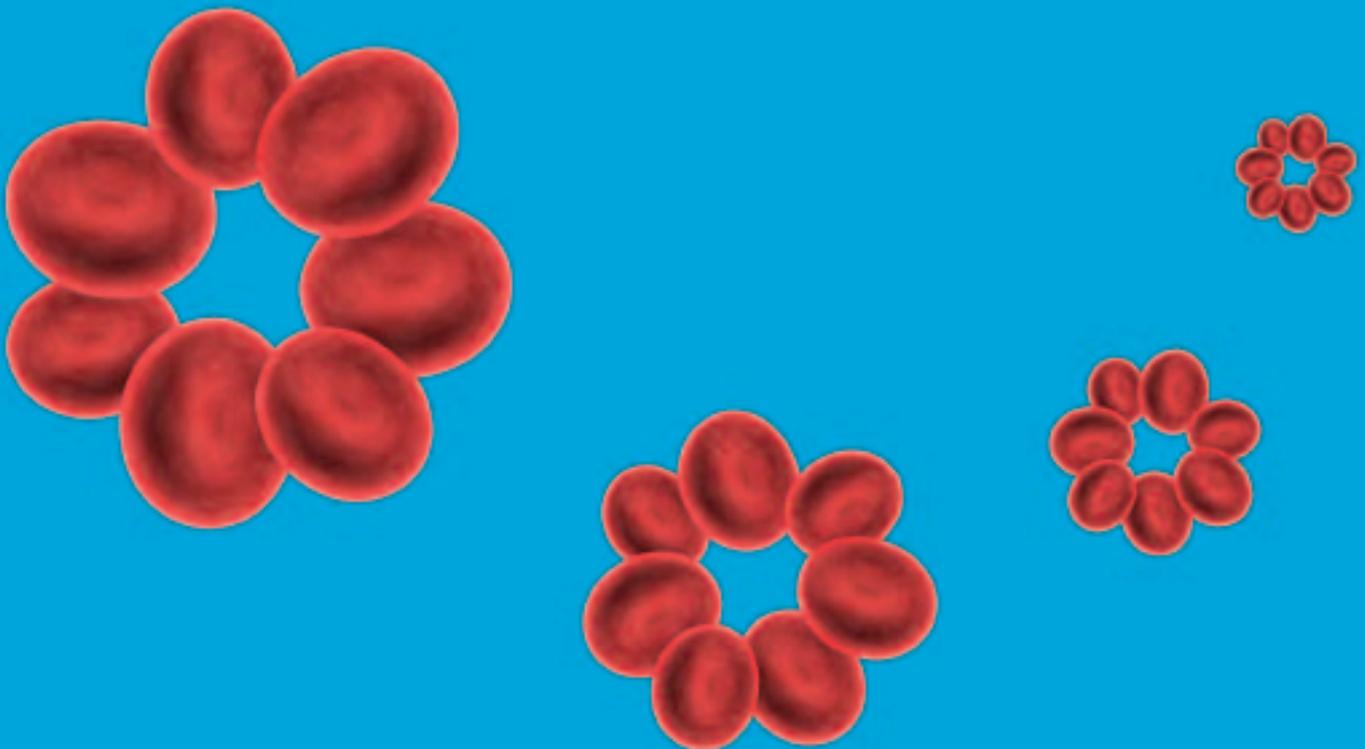
Contents

A year of transformation:	
Chief Executive's foreword	05
NESTA – making innovation flourish	
The human dimension	
– promoting a spirit of enquiry	06
The financial dimension	
– supporting innovators	07
The policy dimension	
– creating a shared understanding of what works	07
Building on past achievements	
Chairman's statement	09
NESTA at a glance	12
The year in review	
Investing in new products and services	13
Developing talent and entrepreneurship	15
Changing the climate for innovation	17
2005–06: Report on strategic priorities	19
Investments and awards 2005/06	20
Financial statements 2005/06	31



“NESTA’s national endowment lets us take a distinctive approach to innovation. It gives us independence and allows us to make decisions for the long term. It enables us to work across the entire ecology of innovation.”

Jonathan Kestenbaum, Chief Executive





“NESTA aims at nothing less than inspiring a sense of national mission around the issue of innovation.”

Jonathan Kestenbaum, Chief Executive

A year of transformation Chief Executive's foreword

This has been a year of transformation for NESTA. We have renewed our vision, clarified our aims and focused our programmes. Our vision is of the UK leading the world in the application of knowledge, enterprise and creativity.

Throughout the year we have worked intensively to develop the capacity and programmes that we need to play our part in achieving that vision. We have a great team in place and have developed a vigorous strategy for the next five years.

As we work to create our 'preferred future', we visualise NESTA as:

- a creator of highly successful models for innovation that are replicable and scaleable;
- an innovator in early stage investment;
- a thought-leader and authoritative voice on innovation – seen as an essential and trusted source of advice by government and industry;
- a high performing organisation – an exciting, dynamic and rewarding place to work;
- an ideas-led, publicly accountable organisation that inspires others.

Fostering innovation is a key priority for the UK. At a time of intensifying global competition, the UK will only succeed if it develops new ideas, new products and new services. At the same time, we need innovative solutions to address the urgent social and environmental issues we face.

If the UK is going to respond effectively to these challenges, it needs a more integrated approach to supporting innovation. NESTA has an important role to play in achieving this. Our ambition is to make NESTA the single, most powerful catalyst for innovation in the UK. Our success will depend on the strength of the partnerships we form with policymakers, business people, education leaders, and of course other investors.

Our approach is to develop an innovation framework based on three main foundations:

- Building a more pervasive culture of innovation.
- Providing effective access to early-stage risk capital.
- Helping to create a policy environment in which innovation can flourish.

This will require us to create vibrant networks where people share ideas and expertise. We will support a new generation of innovative thinkers and entrepreneurs prepared to take risks on the strength of their creativity and talent, as well as provide effective access to early stage finance. Finally, we will use our knowledge and insights to shape a strong, enriched innovation policy framework.

To put it simply, we are here to inspire, to invest and to inform.

We have already made a significant contribution in these areas; something that was acknowledged by the additional £75 million we received from government this year; £15 million a year over 5 years.

Endowment funding of over £300 million puts us in a unique position. For example, it enables us to be the UK's largest provider of seed capital and to take risks on promising early-stage investments.

But to achieve our ambitions we need sharper focus. Our aim is always to maximise the impact of our activities, and the economic and societal value they create. That is why we are building strategic partnerships with fewer, but more scaleable and ambitious, programmes with a particular emphasis on inter-disciplinary co-operation among innovators.

If we are to meet our aspirations, we must hold ourselves to account to the highest possible expectations in terms of impact and excellence, and in doing so we will encourage others to do the same. Our future success is dependent on our ability to galvanise in others the passion and commitment to transform the UK's capacity for innovation. We aim to inspire nothing less than a national mission around the issue of innovation.

I'd like to take this opportunity to thank all staff and trustees for their hard work during this year of transformation. Ours is an exciting task at a critical time, and I look forward to the year ahead with great enthusiasm.



Jonathan Kestenbaum
Chief Executive

NESTA: making innovation flourish

Innovation is a top priority for the UK in order to bring new ideas to market and to address urgent social and environmental issues.

Without innovation, the UK cannot compete successfully with the low-cost labour markets of newly industrialised countries, which are also making rapid technological advances. Many other countries are also developing creative industries, high-tech sectors and intellectual property. To thrive in this highly competitive environment, the UK needs to be among the best of innovative countries.

So what makes innovation flourish? What are the conditions in which creativity and invention thrive?

First, there needs to be a **spirit of enquiry** and enterprise in the UK, particularly in education and business. People need to be enthusiastic about innovation. We want to encourage a more can-do, risk-taking culture in the UK, and to inspire talented people to develop their ideas.

Second, there has to be **support for innovators**. This includes finance, but critically it also means mentoring, advice and other forms of support. We will back potentially successful, innovative businesses in a range of ways, sometimes with other funders such as venture capitalists or business angels. Our aim is to generate a commercial return and therefore showcase successful models of investment that can be repeated elsewhere.

Third, there has to be a **shared understanding** of what makes innovation happen among policymakers, legislators, opinion formers and educators. We need to be experts in the act of innovation itself. NESTA's role is to be a centre of expertise, based on experience and research. Our aim is to stimulate deeper engagement about innovation and have a positive influence on policy.

NESTA's work is based on three 'dimensions' – human, financial and policy – to reflect these conditions for successful innovation.

The human dimension:
promoting a spirit of enquiry

The human dimension of our work is about encouraging curiosity and enterprise right from the early years of education through to the workplace and beyond. Our programmes in this area include:

Future Innovators – partnerships in the education world designed to nurture and inspire the next generation of innovators.

Creative Pioneers – developing the commercial expertise of creative individuals to support business growth.

Innovation Challenges – challenging people to come up with solutions to problems in areas such as health and the environment, and demonstrating how different incentives, such as competitions, prizes, intellectual property rights or grants, best stimulate innovative ideas and behaviour.

NESTA Connect – projects that demonstrate how innovation can be encouraged through networks and collaborations – bringing together public and private organisations, independent innovators and end-users, and connecting people from different disciplines to generate new ideas.

NESTA's aim is to enrich our understanding of innovation, and to use this knowledge to create models and solutions which others can adopt.

“We need a culture of innovation in the UK. The foundation of this will be an education system in which all young people achieve high standards in the basics, open their minds to the world around them and develop the confidence and inspiration to change it for the better.”

Sir Michael Barber, NESTA trustee

The financial dimension:
supporting innovators

As the investor with the largest single UK endowment exclusively devoted to supporting talent, innovation and creativity, NESTA is in a unique position. We play a distinctive role in the early-stage investment community – not only looking for returns, but also creating more liquidity, generating higher quality deal flow and building models of best practice.

NESTA Investments invests in high growth start-up businesses.

We make investments directly into businesses, often with others. We usually invest £50,000-£250,000 initially, and up to £500,000 in total.

We act as a corner-stone investor, in partnership with business angels or early seed funding organisations, in this way exploring other models of early-stage investing.

Our experience has shown us that start-up companies don't only need money. They also need extensive non-financial support to develop professional business skills. That is why we are broadening our network of mentors, working in partnership with others and looking to facilitate mentoring beyond those companies in which NESTA invests.

The policy dimension:
creating a shared understanding of what works

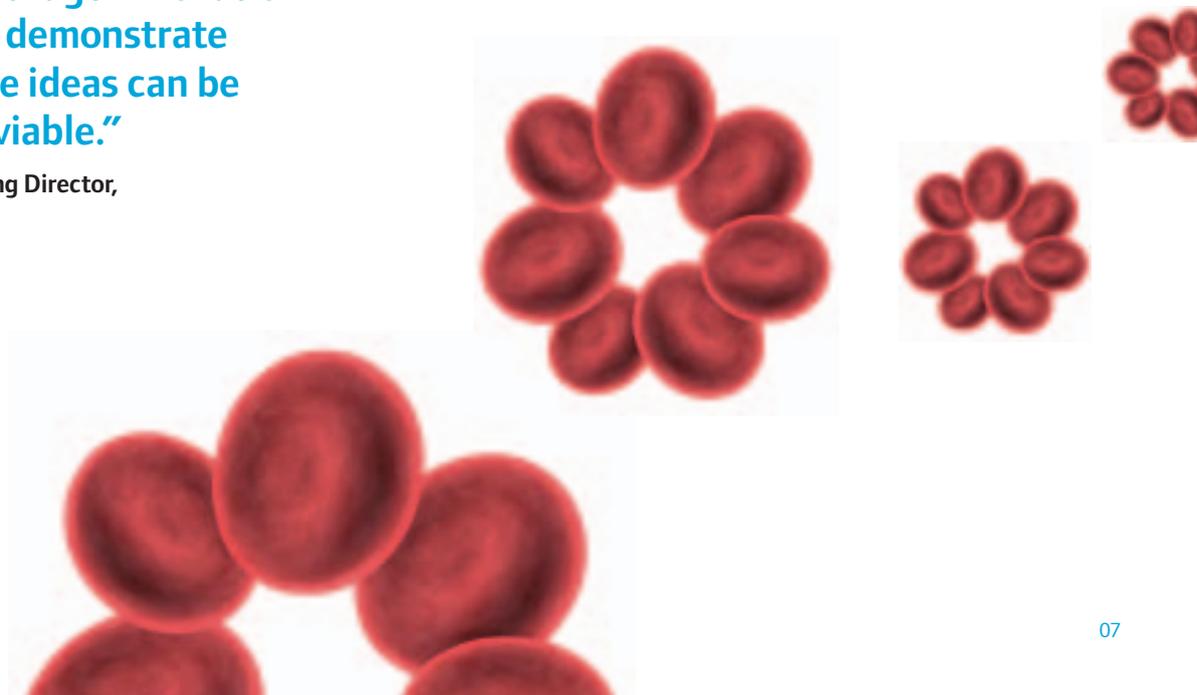
Our activities provide us with first-hand experience of what works in the drive to promote enterprise and creativity. They provide a foundation for NESTA to act as a centre of expertise on how the UK can best encourage innovation. We also conduct research, provoke debate and aim to foster links between all those involved in supporting innovation throughout the UK. Activities in this area include:

Research projects: a programme of managed research in higher education and think-tanks, designed to generate a number of substantial reports every year on aspects of innovation policy.

Creating an innovation network: a nation-wide network of people involved in innovation. To bring them together and stimulate new thinking we will publish a regular electronic newsletter and stage a series of roundtables, seminars and speaker meetings.

“One of the best things we can do to encourage innovation in the UK is to demonstrate that innovative ideas can be commercially viable.”

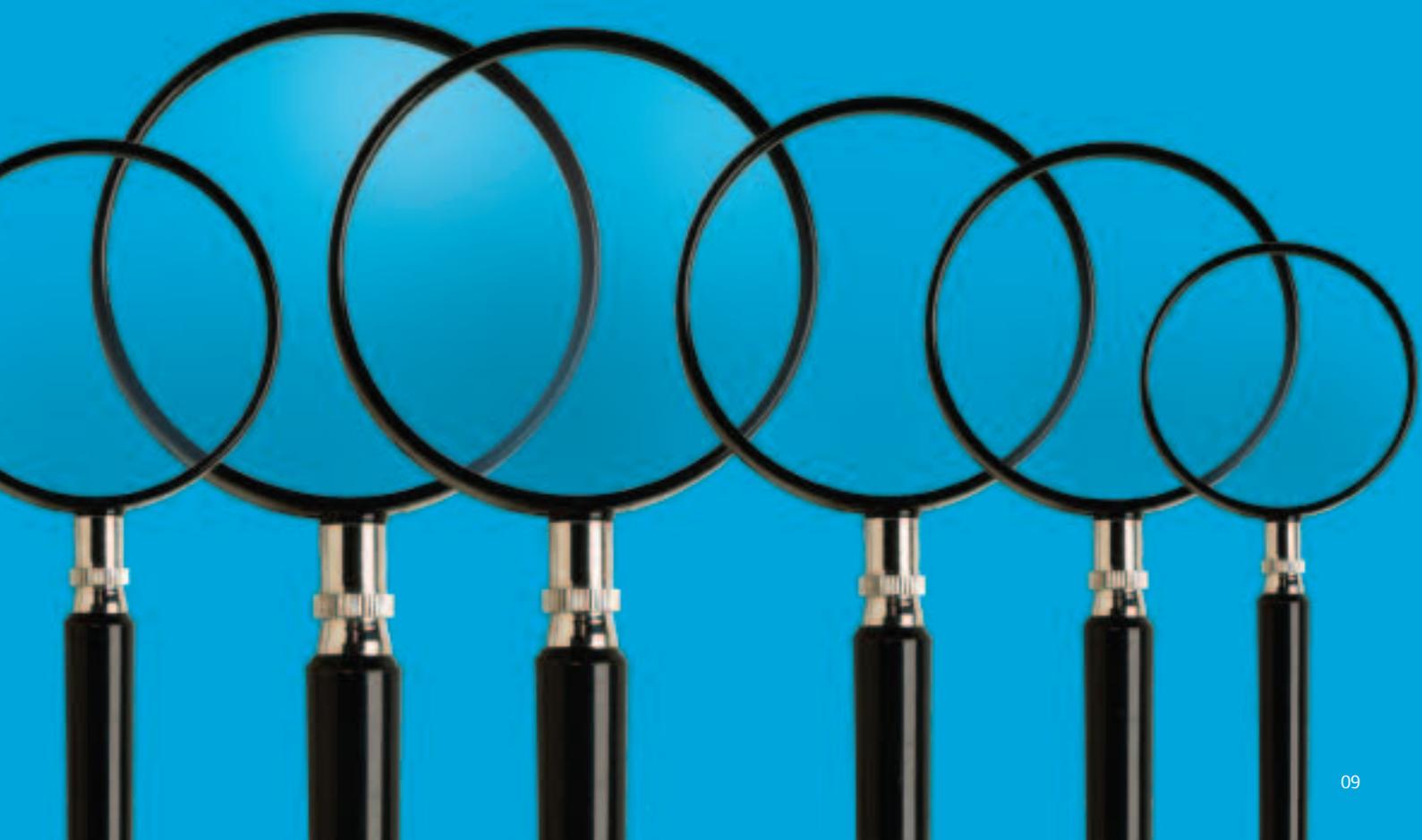
**David Hunter, Managing Director,
NESTA Investments**





“NESTA is here to establish the most effective ways of encouraging talent and innovation for national benefit.”

Chris Powell, Chairman





“ For every £1 we’ve invested in businesses since October 2003, they have attracted £5 of additional funding.”

Chris Powell, Chairman

Building on past achievements Chairman's statement

I extend a warm welcome to our new Chief Executive, Jonathan Kestenbaum who joined us in November 2005, bringing with him extensive experience in venture capital, business management and education. His energy and intellect have already had great effect.

During this transforming year, we continued to back emerging talent (with many successes outlined in this report), and saw the fruits of investments made in earlier years. One of the best expressions of the value we achieve is the extra investment attracted to the businesses we back. Since October 2003, we estimate that for every £1 that we've invested in businesses to help them get their ideas off the ground, they have attracted an average of £5 of additional funding – funding that may not have become available if we hadn't made the initial investment.

NESTA Futurelab – a Bristol-based, blue-skies laboratory developing new learning technologies to help transform the way people learn – is an excellent example of how NESTA incubates ideas until they are robust enough to stand on their own. Set up in December 2001 with £3 million in start-up funding from the Department for Education and Skills, Futurelab has attracted further investment from blue-chip investors such as Microsoft and EA Games. From March 2006, Futurelab became an independent charity. We will continue to work with them on projects and watch their progress with pride.

As Jonathan has mentioned, in February 2006, after scrutiny by both Houses of Parliament, NESTA was granted extra funding of £75 million – £15 million a year over five years. We were extremely heartened by the warm, cross-party support expressed for our achievements over the years. This additional funding recognises the progress NESTA has made in stimulating innovation in the UK and the long time-horizons of many of our investments. It also reflects the size of the task that lies ahead.

Given the uncharted territory in which we operate, it is right that we should now take stock of our progress and our programmes. This year we took a searching look at our performance to date, reviewing all of our programmes and drawing lessons that guided the re-focusing of NESTA that Jonathan Kestenbaum has already described.

NESTA is here to establish the most effective ways of encouraging talent and innovation for national benefit, rather than to focus on any particular discipline. We learn by doing and our programmes evolve as we learn. When projects are rolled out or closed, after a period of evidence-gathering and evaluation, they release funding for new approaches.

Our aim is to report to government on the programmes that work best and to map out those areas where long-term, substantial action would reap benefits. Then we may begin to realise our vision of a UK truly united in its commitment not just to fostering creativity and talent, but to turning creative ideas into world-beating businesses.



Chris Powell
Chairman

NESTA at a glance

NESTA was set up by Act of Parliament in 1998, and we opened our programmes the following year. We've made a significant investment in UK innovation since then.

We have invested more than

£51.5m

in our programmes.

We've made more than

1,000

awards and supported a variety of networks, partnerships, training and mentoring services.

We've invested in more than

300

businesses, many with world-class potential.

We've developed more than

260

innovative and experimental approaches to learning.

The year in review

The last year constituted a new phase for NESTA. The arrival of our new Chief Executive and a deepening knowledge of successful approaches have given us the impetus to develop a radical vision for the UK's future and the part NESTA can play in transforming the UK's ability to innovate.

Throughout the year, we have looked to build on past achievements, taking forward the strongest ideas and focusing our attention on those activities where we can achieve the greatest impact.

We have recorded some notable successes over the year, especially in the areas of attracting co-investors, bringing new ideas and new enterprises to market, and launching two research reports which have influenced policy and practice at a national level.

We have also streamlined our own structure and realigned every part of the organisation so that the link between people, programmes, strategy, mission and vision is coherent and clear.

Externally, we've witnessed strong commitment from the government to science and technology, to the arts, and to developing an entrepreneurial society.

Here are some of the investments we made during the year:

- Cambridge firm **CellCentric**, which works with leading scientists to identify proteins that can find and destroy cancer cells and the molecules which influence their spread;
- **Symetrica** of Southampton, which is developing a 'drive-through' security scanner to detect and differentiate between forms of radioactivity emitted from sources as diverse as a dirty bomb, a cancer patient, a truckload of ceramic tiles and a crate of bananas;
- Bristol-based **Micrima**, which received funding for developing a radical new way of screening for breast cancer using microwave radar technology, adapted from research originally used in landmine detection.

Investing in new products and services

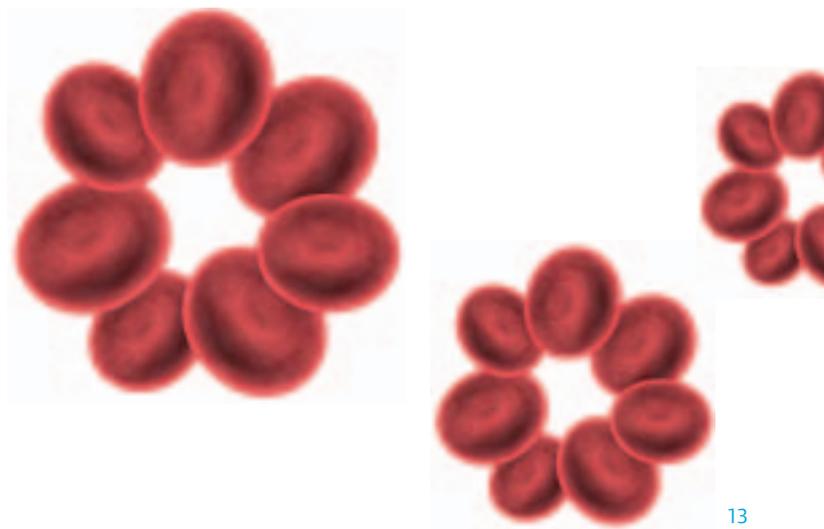
NESTA's Invention and Innovation programme has supported potentially successful, innovative businesses by combining early risk capital with access to specialist mentors, introductions to other potential investors and support from a wide range of networks. To date, the programme has invested £15.6 million in a total of 200 new business ideas.

Attracting co-investors

Several of the companies we backed with early-stage seed capital secured major follow-on financing during the year.

In the world of transport, Advanced Transport Systems (ATS) received a £7.5 million investment from BAA to develop its ULtra system of driverless taxi pods for Heathrow, ferrying passengers from the terminals to their cars. NESTA was the first company to make a commercial investment, back in 2000 when we invested £75,000. Over the years, our investment in ATS amounted to £250,000, a level of funding which encouraged private investors to get involved when the company most needed it.

A first for Britain – no other country has such a system – it could prove the next step towards computer-controlled, low-pollution cars.



The year in review continued



Substantial co-investment for pioneering medical treatments

Two NESTA-supported British companies working on advanced medical technologies received a major boost through investments totalling £5.7 million.

The companies – **Haemostatix** and **Veryan Medical** – are examples of British firms successfully exploiting world-class science. Both have the potential to transform

patients' lives, improve medical practice and benefit the UK economy. Both received very early risk capital from NESTA, helping them to develop to the stage where they were able to attract further investment.

Leicester-based **Haemostatix** raised £3.1 million to help commercialise its pioneering approach to creating artificial platelets in the blood. Platelets help the blood to clot. Their lack is a particularly serious problem for patients with leukaemia or receiving cancer therapy.

London-based **Veryan Medical** raised further funding of £2.6 million from co-investors to develop a radical new approach to kidney dialysis. NESTA's co-investors in this further funding round included Quester, NPI Ventures, Imperial College, Oxford Capital Partners and the East Midlands Regional Venture Capital Fund.

Investment competitions

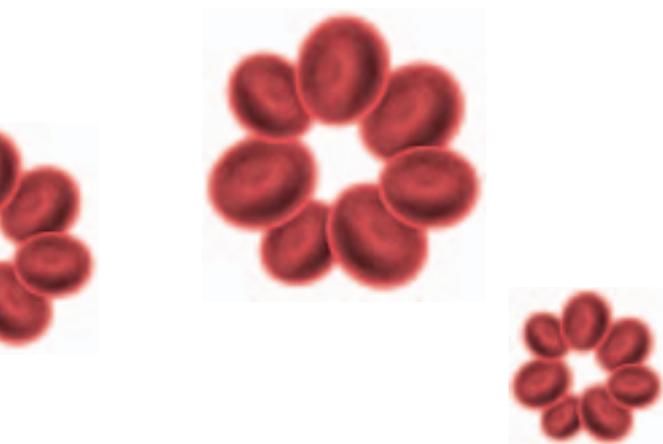
Unlike traditional venture capital funds, whose main interest lies in direct investment and generating fairly rapid returns, we also look for other ways of helping entrepreneurs commercialise their ideas and prepare themselves for business. We have continued to develop exciting challenges and competitions for entrepreneurs, offering the reward of fast-track training in business skills for successful applicants.

These challenges are usually directed at particular sectors. For technology innovators, for instance, we launched **Zero-to-Hero 2006**. This business training competition invited winning applicants to a one-day work camp to discuss their businesses with leading venture capitalists from the early-stage sector.

The Faraday Partnerships Investment Competition for emerging technology entrepreneurs announced its first winner in January 2006: **Michelson Diagnostics** from Chislehurst, developer of a novel laser-scanning imaging technology which minimises the need for painful biopsies in organs such as the cervix and lungs. NESTA offered an initial award of £15,000 and corporate sponsors pledged a further £200,000.

In 90 per cent of creative businesses, less than half of all senior managers have received any training in business strategy.

Source: NESTA, Creating Growth: How the UK can develop world class creative businesses.



Developing talent and entrepreneurship

The UK has a good record in nurturing young talent and creativity across science, technology and the arts. But we also need to help our innovators commercialise their ideas.

During the year, we concentrated our efforts in these main areas:

- supporting creative entrepreneurs;
- developing outstanding talent and the innovators of the future;
- encouraging creative and critical thinkers.

Support for creative entrepreneurs

The UK's creative industries range from advertising and architectural practices to performing arts companies, computers and video games. Many are world class and the sector as a whole offers major growth opportunities for the UK economy.

Launched in 2003, our Creative Pioneer programme (CPP) offers a robust model for identifying new talent and giving people the business and financial skills they need to set up new creative businesses. Start-up grants to this year's crop of creative pioneers rewarded original business ideas and showed how creative talent can take the lead in developing the UK's economy for the 21st century. By the end of March 2006, the programme had helped to launch more than 100 new businesses initiatives, as well as training a further 50 business pioneers.

During the year, we rolled out our successful training for creative pioneers through an initiative called Insight Out. This new initiative gives more graduates of creative industries courses, across the UK, the chance to acquire skills in business planning and to apply for small start-up funds.

Altogether, we invested over £1.1 million in creative businesses during the year via CPP and Insight Out, making a total of £2.8 million since we first launched the programmes.

Encouraging design companies to develop and grow

The UK's design industry has a wealth of talent that makes it a vital part of the nation's economy. But compared with other industries, most design companies remain small.*

Working with Design Business Association and creative business accelerator, Pembridge Partners, we launched **Small/Medium/Large** as a competition for small design companies. The winners gain expert advice on how to grow their business without compromising their creative integrity, client service or profitability.

*Source: British Design Innovation Survey (2004/05)

A pioneering business model for the film industry

NESTA's support for individual companies will often test out new approaches that bring wider benefits to their industries. In June 2005, for instance, NESTA invested £150,000 in **Headline Pictures**, a small start-up company headed by award-winning industry professionals.

The investment is intended to help the company develop a pioneering business model, based on retention of rights, while continuing to produce high-quality, commercially viable film and TV productions.

The year in review continued

Developing outstanding talent

Innovation is fed by a constant stream of new ideas that challenge existing thinking and break new ground. Since we started we have awarded 265 Fellowships to leading figures from all branches of science, technology and the arts, and those whose work crosses traditional boundaries. The aim has been to stimulate new work and new thinking that will also benefit their peers.

Among this year's Fellowships, academic **Tom Shakespeare** is using his award to widen the debate around genetics, ethics and disability, using theatre, literature and film. Palaeontologist **Dr Philip Donoghue's** award is helping him to find the missing links in evolution, combining his specialist knowledge of the fossil record with genetics, to help understand how organs in the body evolve. Biologist **Anne Osbourn** is supporting a new approach to engaging children in science, presenting scientific images as an inspiration for poetry in a series of school workshops, publishing the poems in an anthology.

Successful entrepreneurs often start young, driven by innate ambition and a willingness to accept a challenge. Over the last seven years, our Learning programme has developed over 260 new approaches to stimulating entrepreneurship and innovation. Ignite!, NESTA's Fellowship project for outstandingly creative young people, gave us more insights into how to unlock latent creativity and encourage young people to push the boundaries of their imagination, using workshops and creative labs. Altogether the programme reached 783 young people during the year.

Only 17 per cent of science teachers think that the curriculum allows a lot of scope for practical experimental work.

Source: NESTA, Real Science.

Stimulating entrepreneurship among secondary school pupils

In partnership with local schools and Creative Partnerships Merseyside, we launched **Hotshots Entrepreneurs Academy** to uncover the next generation of entrepreneurs in the North West. Open to secondary school pupils throughout Merseyside, it invited 30 young people to a two-day master class on managing risk, creative thinking and motivation. The final stage took just 12 of these to the Lake District for a week-long academy designed to perfect their business ideas.

Encouraging creative and critical thinkers

As one way of supporting innovation, NESTA sets out to encourage creative thinkers and people prepared to challenge received wisdom. This includes those whose skills drive innovation forwards, such as scientists, technologists and artists.

Initiatives such as **Planet Science** have sought to engage young people in science from an early age, both to create the visionary scientists of the future and to let science inform their ways of thinking. NESTA also has a role in bringing together scientists from different disciplines, to stimulate new ways of working and engaging people in science.

NESTA has also made a significant contribution providing funding for science learning. Up to the end of the financial year, we have invested £3.1 million for projects promoting science learning in schools and supporting the public's appreciation of science. For example, we've supported the **Creative Science Engagement Network** (CreScENDO), which aims to maximise the benefit and impact of science communication projects such as sci-art activities, academic outreach programmes, curriculum development and teacher Continuing Professional Development. CreScENDO facilitates knowledge sharing and provides advice and support.

Changing the climate for innovation Research and policy work

Innovative ideas need the right conditions to flourish. This means working to make sure that government's fiscal and regulatory regime supports and sustains the efforts of people who want to bring their new ideas to market. It requires strong early-stage investment and business support measures. It also calls for a wider cultural shift which embraces risk and supports a more entrepreneurial spirit.

Since we made our first awards in 2000, NESTA has built up a unique understanding of the needs of pioneers across the fields of science, technology and the arts, and the kinds of support that bring most benefit. We aim to take a leadership role in promoting innovation, and we have built up a strong presence around the nations and regions of the UK. The benefits flow both ways: our support reaches all corners of the UK, and our network keeps us in direct touch with emerging talent and needs throughout the UK.

Over the past year, our efforts to improve the climate for innovation in the UK concentrated on two main areas:

- strengthening our body of evidence through research and sharing our learning with government and others, to influence policy;
- developing and supporting creative networks and partnerships around the nations and regions.



Science enquiry and problem-solving

A poll conducted for NESTA by ICM supported our views on the importance of 'science enquiry' in schools. Hands-on, scientific experimentation and science enquiry stimulates students to take up science as a career or in further education. Yet two in three science teachers said that they lacked time for science enquiry work within the current curriculum.

We published research reports on two issues of particular relevance to our area of work:

- science teaching in schools;
- business growth in the UK's creative industries.

Launched in November 2005 at the new National Science Learning Centre at York, **Real Science** urged a more hands-on approach to science teaching in schools, making science and its mysteries more exciting and more fun. The UK's future international competitiveness demands that our scientific research base and our general scientific literacy are strong enough to meet the challenge of our competitors. Science enquiry can motivate learners and support significant gains in attainment, even by young people who have previously struggled with science.

Focusing on investment issues, **Creating Value** (2005) was our second report on the UK's creative industries, which NESTA has long viewed as vital to the UK's economic future. Launched in a joint seminar with the DCMS, the report's main conclusion called for a new emphasis on the commercial value of selected businesses, rather than continued stress on their 'exceptional' needs.

In November 2005 the Government launched a major consultation programme to strengthen policy aimed at making Britain the world's creative hub. NESTA used its research to contribute to the Government's creative economy programme – with representation on six of the seven working groups.

We also used our research to stimulate discussion around the country, exploring policy implications through a range of regional and national seminars. Additionally, we worked with Creative Clusters in Belfast to lead discussions on investing in creativity.

By promoting our research findings and programme activity in this way we hope to encourage policymakers and programme-builders to adopt a more commercial approach to the creative industries. We want others to benefit from what we have learnt about stimulating entrepreneurship and growing businesses.



Creative networks and partnerships

Encouraging more dynamic networks and collaborative partnerships is another strand to the way we seek to boost the UK's capacity to innovate. Networks play a pivotal role in accelerating innovation, by helping to share knowledge across disciplines and sectors, and providing access to expertise and finance.

In the West Midlands, NESTA has set up a new creative hub, delivered by Channel 4's IDEASFACTORY West Midlands. It provides useful networking opportunities and seminars for entrepreneurs starting out in the creative industries. NESTA has also supported creative hubs in Northern Ireland and Wales. These were delivered by the Northern Ireland Business and Innovation Centre with support from Belfast City Council, and by Bloc, with support from Welsh Development Agency and Arts Council Wales.

The creative industries are vital to the UK's economic growth. They account for over 7 per cent of UK GVA and employ 1.8 million people. Between 1997 and 2004, they grew by an average of 5 per cent a year, compared to an average of 3 per cent for the economy as a whole.

Source: Department for Culture, Media and Sport (2005) Creative Industries Economic Estimates - October 2005, (DCMS, London).

A vibrant network for scientists



Innovation often occurs at the meeting point between disciplines, yet networking between the different branches of science is surprisingly rare.

NESTA's **Crucible** initiative aims to fill this gap by providing a meeting place for postdoctoral scientists from a wide variety of disciplines. To date, NESTA has run six residential weekends for early-career scientists and engineers, and demand has far outstripped the number of places available. The weekends stimulate new ways of thinking about science and scientific practice, sharing experiences and ideas.

Collaborative working is critical to the way we aim to spread our message that it pays to innovate. As just one example, working initially with Yorkshire company Blink, we developed an initiative – known as **Pocket Shorts** – that offers training and financial support for films which can be shown on mobile phones. The audience for mobile videos is huge, with 2 billion mobile phone users worldwide, and over half of all phones expected to have video capability by 2007. In August 2005, we extended the scheme to Scotland in collaboration with Scottish Screen and Scottish Enterprise. Our aim is to stimulate a new generation of creative entrepreneurs, providing a space for companies to emerge and promote their work to a global audience.

Another response to improving NESTA's reach has been to set up advisory 'champions' groups in Scotland, Wales and Northern Ireland. These help us to respond to new opportunities and to support innovation in ways that work for all nations and regions.

Much remains to be done but, as this report has shown, after a year of significant achievements and renewal, NESTA is poised to meet the challenges that lie ahead.

Report on Strategic Priorities 2005/06

In our Annual Report for 2004/05 we set out a number of strategic priorities for 2005/06, the last year of our current strategic plan. These are reproduced below, along with indicators of our progress against each.

Promoting NESTA as an 'expert witness' to influence the activities of funders, practitioners and policy makers and identifying new opportunities and partnerships.

- NESTA published two research reports; **Real Science** and **Creating Value**. **Real Science** makes the case that innovative approaches to experimental and investigative science learning should be at the core of science education in the UK. It also shows that this approach to learning has the potential to reverse the apparent decline in young people's interest and engagement in school science. **Creating Value** (2005) looks at what needs to be done to ensure that the best possible conditions exist for greater levels of investment in new business sectors in the creative industries, and examines the respective roles of private and public sector investment.

Continuing to work with our current portfolio of awardees to maximise value generation. We will achieve this by focusing on added value support and capturing and implementing the learning from our projects and programmes.

- NESTA has continued to offer mentoring and business support.
- We've successfully 'spun out' some of our pilot initiatives – for example **NESTA Futurelab**, which explores innovation in interactive learning technologies, and **Insight Out** academies, which offer business training and support.
- The results of our programme evaluations carried out in 2005/06 and our wider learning have been important in informing the work on our strategic review and plan for 2006-11.

Realising efficiency gains.

- During 2005/06 we finalised plans for a move to new premises in 2006/07. This has been designed to provide savings in maintenance and support, energy use and other running costs, and to improve working practices.
- During 2005/06 almost all maintenance and support contracts were re-tendered, producing substantial cost reductions. Savings were also made in legal and professional fees and investment management costs.

Implementation of a Nations and Regions Strategy to enhance NESTA's UK presence.

- We continued to strengthen our engagement across the UK during 2005-06, developing our networks of 'champions' in Scotland, Wales and Northern Ireland and establishing a new office in the North East of England with support from One North East and Arts Council North East.
- We also focused on building tailored partnership programmes specific to the needs of different parts of the UK; **Starter for Six**, for example, is a major project developed in partnership with the Six Cities Design Festival and Highlands and Islands Enterprise that will support up to 300 creative entrepreneurs across Scotland over the next 3 years.

Development of the Strategic Plan for 2006-11, incorporating developmental research and the results of the full evaluation programme.

- We've undertaken a thorough strategic review and will publish our new strategic plan by the end of 2006.

Implementation of shorter-term implications of programme evaluation projects.

- Key changes included a greater focus on a limited number of sectors within the Learning programme and moves to greater team-based rather than purely individual support within the Fellowship programme.

Investments and Awards 2005-06

Developing talent and entrepreneurship

Learning awards: pioneering approaches to learning

Artwork /Future Something Project	£10,000.00
Bath and NE Somerset Arts Development /5x5x5	£8,057.00
Belfast Exposed /Gateways	£118,725.00
Black Arts Alliance /Barred Words	£30,000.00
Box New Media Ltd /Face to Face	£141,593.00
Bradford Museums /Learning Journeys	£115,000.00
Breakthrough Films /Peter and the Wolf	£30,000.00
Brighton Festival /Adopt an Author	£12,125.00
Centre for Science Education /Risky Business	£30,000.00
Cheltenham Arts Festival /FameLab	£30,000.00
Children's Music Workshop /Exploring Identity	£14,000.00
Chris Morley Consulting /New Directions in Digital Media	£80,000.00
Dance United /The Academy	£218,000.00
Djanogly City Academy /Dance into the Future	£30,000.00
Dream Ireland /Dreamlab Learning	£199,420.00
ECSITE-UK /The Ecsite UK Conference	£9,250.00
Edinburgh International Science /Underground Talent	£7,500.00
Francis Charters /Achieve4.me	£30,000.00
Futurelab Education	£755,422.00
Germination /The Reel Bollywood	£15,200.00
Goldsmiths College /Making Waves	£199,944.00
Intuitive Media /Grandmother and Me	£57,600.00
Irie Dance Theatre /Dance and Diversity	£6,600.00
Learning Tapestry /Music and the Mind	£25,000.00
Lister Community College /Digital Media Arts	£131,500.00
Llangollen Museum /Valle Crucis Abbey	£92,800.00
Magna Science Centre /Enlighten Magna	£80,000.00
Mando Group Ltd /Hotshots Entrepreneurs' Academy	£30,000.00
Moving Being Ltd /Alternating Currents	£47,500.00
Mythstories /Move It, Touch It, Feel It	£24,150.00
National Collaborative (supporting 20 schools)	£276,100.00
National Debate with a Difference	£22,920.00
National Drama /Drama for Learning & Creativity	£30,000.00
National Marine Aquarium /Little Nippers	£78,500.00
National Theatre /Teamworks	£68,645.00
Newcastle City Council /Community Sounds and Voices	£119,816.00
Norton Priory Museum Trust /St Christopher's Coat	£75,950.00
PAL /Creative Science Teaching Lab	£30,297.00
PK Trust /WAVES Science Sculpture Park	£2,714.00
Queens University /Silver Sounds	£80,000.00
Raploch Urban Regeneration /Radio Raploch	£14,800.00
Razor Edge	£18,014.00
Rothamsted Research /Drive online	£16,284.00

Learning awards: pioneering approaches to learning continued

RSA/WEEE Man	£30,000.00
Rural Arts/Click Move	£45,020.00
Scottish Executive/Boosting Science in Scottish Schools	£17,000.00
Sheffield Galleries & Museums Trust/Narratives	£12,725.00
Sheffield University/Making Chemistry Practical	£43,000.00
Snug & Outdoor Ltd/The Experimental Playground Kit	£30,000.00
The Drake Music Project/E Scape	£28,857.00
The Open University/Aspire	£44,105.00
The Thomas Hardy School/Films for Learning	£26,855.00
Toolkit/Whatwashere	£219,670.00
University of Oxford Department Of Psychiatry/Blue Room	£30,000.00
University Of York	£1,500.00
Visual Physics	£23,000.00
Web Play UK/The Page to Stage Platform	£143,825.00
Wellcome Trust/Digital Science	£15,000.00

Creative pioneer programme: support for creative industry entrepreneurs

Catherine Greig/make_good Ltd	£35,000.00
Concentrate	£8,850.00
Create Consult Media/Design Business Association	£103,283.00
Diana Irani/re_medi	£35,000.00
Emily Mantell/P Rude Ltd	£35,000.00
Gavin Morris/Boredbrand Entertainments Ltd	£35,000.00
Glasgow School of Art/Insight Out	£20,000.00
Gopal Dutta/Brown TV	£35,000.00
Hannes Koch/Operation Schoener Ltd	£35,000.00
Heather Sloane/We Can Fly	£35,000.00
Jane Ni Dhulchaointigh/Formerol Ltd	£35,000.00
Kelly Atkins/Carpet-Burns	£35,000.00
Laura Williams/Zest Design	£35,000.00
Lisa Larsson	£34,574.00
Matthew Dearlove	£35,000.00
Megyeri & Partners Ltd/Sweet Dream Security	£35,000.00
NFTS	£45,000.00
Priya Prakash/Life Is Too Short	£35,000.00
Richard Woods/DIY Kyoto Ltd	£35,000.00
Scottish Screen/Pocket Shorts	£101,000.00
Sunderland University Media Centre	£45,000.00
The Lighthouse/Insight Out	£40,000.00
University of Central England/Birmingham Conservatoire	£45,000.00
University Of Central England/Insight Out	£55,000.00
University Of Teesside/Insight Out	£100,000.00
University Of Ulster/Insight Out	£55,000.00

Investments and Awards 2005-06 continued

Fellowship: developing innovative talent

Aejaz Zahid	£75,000.00
Christine Borland	£75,000.00
Daniel Blackburn	£68,000.00
Dharambir Singh	£74,990.00
Duncan Higgins	£74,940.00
Graham Barber	£73,200.00
Hugh MacPherson	£74,588.00
Jane Harris	£67,900.00
Jenny Hanson	£61,550.00
Kentake Chinyelu-Hope	£36,250.00
Lindsey Hall	£52,250.00
Louise Mitchell	£47,180.00
Louise Wilson	£45,500.00
Marlene Smith	£63,107.00
Michael Edmonds	£63,500.00
Peter Coates	£60,000.00
Philip Donoghue	£72,210.00
Rebecca Truman	£71,355.00
Richard Vane Wright	£69,500.00
Shona McCarthy	£51,770.00
Simon Warner	£47,970.00
Stephen Manthorp	£31,700.00
Su Sayer	£53,500.00
The Clore Leadership Programme	£105,000.00
The Crucible Programme	£63,079.00
The Daphne Jackson Trust	£30,000.00
Thomas Wexler	£73,770.00
Tom Shakespeare	£74,411.00

Ignite!: developing outstanding young talent

Anna Fazackerly	£4,050.00
Ashgrove Primary School	£1,500.00
Ashwater Primary School	£1,500.00
Awards to young Igniters (72 awards)	£72,000.00
Bideford College	£1,500.00
Buckhurst Hill Primary	£1,500.00
CCC Pennoweth Primary School	£1,500.00
Cleopatra Muchemwa Rover	£10,700.00
Cornwall County Council	£1,500.00
Devon County Council	£1,500.00
Hazelwood College	£1,500.00
Katie Chapman	£7,700.00
Lipson Community College	£1,500.00
Lipson Community College	£3,850.00
Marlborough Primary School	£1,500.00
Maya J Coles	£7,700.00
Mount Street Primary	£1,500.00
Mount Wise Primary School	£1,500.00
Mounts Bay School	£1,500.00
Mr S Whatley	£1,500.00

Ignite!: developing outstanding young talent continued

Nicholas Rushby	£7,650.00
Notre Dame RC School	£1,500.00
Our Lady of Lourdes Primary School	£1,500.00
Simon Green	£4,050.00
St Anne's Primary School	£1,500.00
St Boniface's College	£1,500.00
St Joseph's Primary School	£1,500.00
St Patrick's High School	£1,500.00
T Y T Fok	£7,650.00
The Birches Primary School	£1,500.00
Trevithick School	£1,500.00
West Croft Junior School	£1,500.00

Investing in products and services**Invention and Innovation: providing early stage finance and business support**

Airjack 2000	£15,000.00
Atmos Ltd	£30,000.00
Autoload Ltd	£30,000.00
Camfridge Ltd	£30,000.00
Cellcentric Ltd	£149,998.00
Dialog Devices Ltd	£50,000.00
Headline Pictures Ltd	£150,000.00
Magic Light Animation Ltd	£15,000.00
Magnicap Ltd	£30,000.00
Meciria Ltd	£150,000.00
Micrima Ltd	£150,000.00
MMIC Solutions Ltd	£150,000.00
MMIMI UK Ltd	£180,000.00
Orderly Q Ltd	£30,000.00
Parafricta	£5,000.00
Plasma Antennas Ltd	£30,000.00
PRI Scotland Ltd	£25,500.00
Probe Scientific Ltd	£94,920.00
Quotient Diagnostics Ltd	£125,000.00
River Of Life Ltd	£15,000.00
ROBAT Ltd	£14,556.00
Short Fuze Ltd	£30,000.00
SolarStructure Ltd	£30,000.00
SORS Ltd	£25,000.00
Spiral Gateway Ltd	£145,000.00
St Andrews Fuel Cell Ltd	£150,000.00
Symetrica Ltd	£150,000.00
Tideway Systems Ltd	£47,160.00
Veryan Medical Ltd	£150,000.00
Water Innovate Ltd	£150,000.00
Wright Fenn Ltd	£45,000.00

Director's 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

2006 has been a year of change for NESTA, with the development of a new strategic mission to transform the UK's capacity for innovation, as described in the CEO's Report on page 5.

The new mission has been supported by a transformation of NESTA, both in terms of programmes and internal structure. This process is more fully described in the CEO's Report on page 5. As part of this process, a programme of voluntary and compulsory redundancies was announced in the year. As set out in Note 7 to the Accounts, the costs of redundancies and payments in lieu of notice are estimated at £768k.

The year has also seen the approval by Parliament of an addition of £75m to NESTA's Endowment from the National Lottery for the continued development of NESTA's work. The first £15m of this was received during the year and the balance will be paid in equal instalments of £15m per annum for the following four years. As described more fully in Note 9(a) to the Accounts, this amount is available to be spent by NESTA in supporting its programmes and operations.

During the year, NESTA also transferred its NESTA Futurelab operation to a newly created independent charity: Futurelab Education. This move is an excellent example of NESTA's operating model of acting as a catalyst: developing and piloting activities with a view to ensuring their take-up or development by other organisations. Both NESTA and Futurelab Education believe this transfer will enable the Futurelab business to build on its success.

Financial Overview

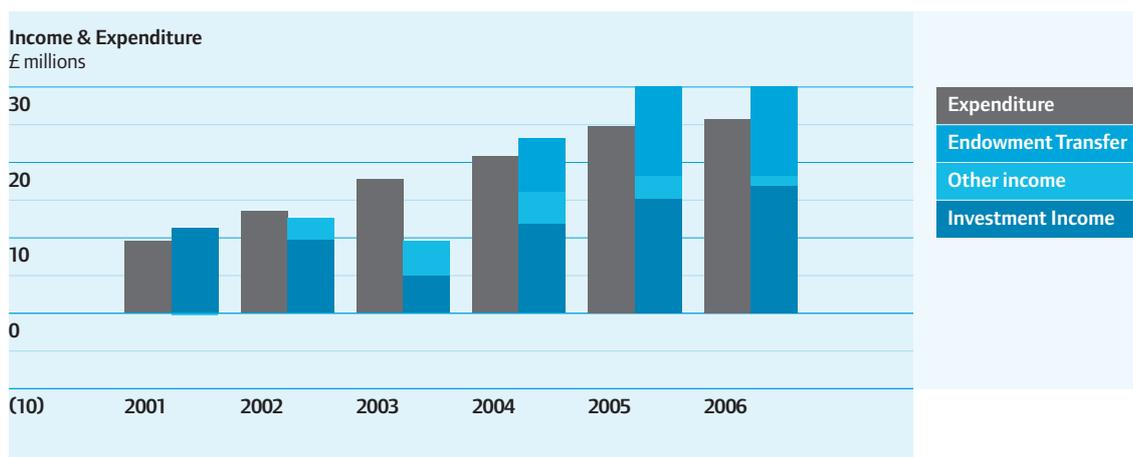
The Accounts on pages 37 to 39 show the income, expenditure and surplus for the year. These are summarised in the graph below with comparative figures for previous years.

As a result of NESTA's transformation, programme activity was constrained during the year as NESTA sought to limit new commitments to areas expected to support directly its new strategic direction. This led to overall spending remaining relatively flat overall compared to 2005.

Although new programme development is proceeding well, this is a process that takes time and overall activity is expected to remain low for the first part of 2007 before picking up significantly in the second half of the year. Overall spend in 2007 is expected to be similar to 2006.

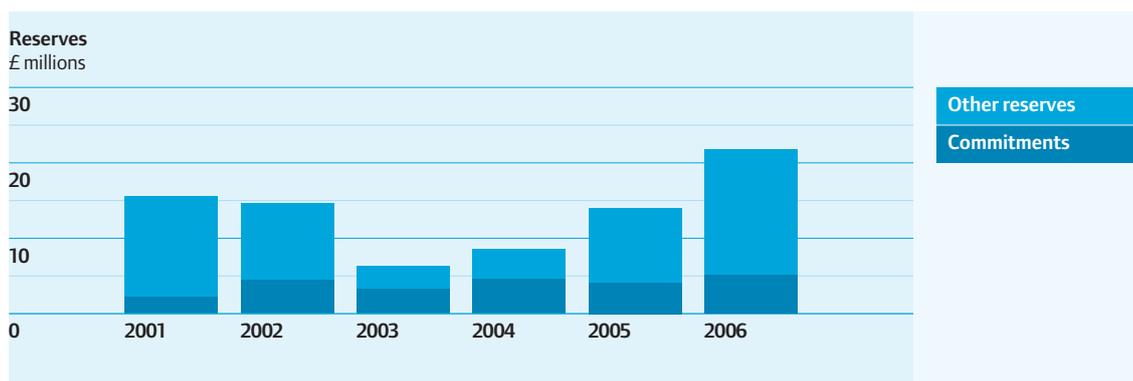
Director's Report and Commentary continued

The ratio of corporate services costs to total expenditure rose from 9.6% in 2005 to 10.9% in 2006. NESTA's restructuring and strategic reorganisation has been accompanied by broadly constant programme expenditure compared to 2005, whilst corporate services costs have risen temporarily as a result. The completion of the reorganisation throughout 2007 will limit changes in the proportion of spend in that year, but significant cost savings and improvements in the balance of spending will occur from 2008.



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 is a summary of soft commitments and available reserves over recent years.

It should be noted that the last three years have seen good investment returns due to strong UK equity and property markets and falling interest rates leading to gains on UK government bonds. NESTA does not expect average investment returns to continue at these levels in future years.



As can be seen from the first graph above, 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 provides sufficient resources to maintain and grow activities for the next 5 years, but NESTA is committed not to return for further additions of this nature after this point.

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.

Director's Report and Commentary continued

Organisational Structure

Chris Powell Chairman	Jonathan Kestenbaum Chief Executive and Accounting Officer from November 2005	Janet Morrison Deputy Chief Executive until July 2006 and Acting Chief Executive and Accounting Officer from March 2005 to November 2005	Jeremy Newton Chief Executive and Accounting Officer until March 2005
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In addition to the Chief Executive and Deputy 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
Roger Gill	January 2005	December 2005	Commercial Executive
Helen Gresty	May 2006		Executive Director Innovation Programmes
Richard Halkett	June 2006		Executive Director Policy & Research
Tom Hawkins	July 2004		Chief Financial Officer
David Hunter	June 2006		MD NESTA Investments
Phil Jones	September 2004	October 2005	Learning Executive
Angela Salt	June 2006		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		Creative Pioneer Programme, NESTA Futurelab
Daniel Alexander	June 1999	June 2006	Finance & Audit (Chair to June 2006)
Yasmin Anwar	November 2001	November 2005	Invention & Innovation
Tom Bentley	July 2003	June 2006	Learning
Dr Stuart Cosgrove	October 2004		Learning
Anthony Freud	October 2004	November 2005	Fellowship
Professor Julia Goodfellow CBE	December 2004		Fellowship
Dr Tracy Long	December 2003		Finance & Audit, Invention & Innovation
Baroness McIntosh of Hudnall	July 1998	July 2005	Fellowship
Professor William Morris	January 2004		Invention & Innovation
Professor Nancy Rothwell DBE	January 2002	January 2006	Fellowship
Graham Ross Russell	November 2001		Finance & Audit, Creative Pioneer Programme Invention & Innovation, NESTA Futurelab
Dr Simon Singh	June 2002	June 2006	Learning
Sir Derek Wanless	September 2000	August 2006	Invention & Innovation
Prue Skene, CBE	January 2006		Fellowship
Sir Michael Barber	February 2006		Innovation Programmes (Chair)
Andrew Flanagan	February 2006		Finance & Audit (Chair from June 2006)
Marc Clements	July 2006		
Sherry Coutu	May 2006		NESTA Investments (Chair)

Director's Report and Commentary continued

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
Professor John Bates	July 2002	June 2006	Invention & Innovation
Sir Michael Bichard	November 2003		Creative Pioneer Programme
Margaret Bruce	November 2003		Creative Pioneer Programme
Guy Claxton	July 2004	June 2006	Learning
Gillian Crampton Smith	November 2003		Creative Pioneer Programme
Rowan Douglas	March 2005	June 2006	Invention & Innovation
Jonathon Drori	September 2003	June 2006	Learning
Russell Foster	December 2004	June 2006	Fellowship
Felicity Gillespie	July 2004	June 2006	Learning
Marc Gillespie	February 2004	June 2006	Invention & Innovation
Adrian Hall	March 2003	March 2006	NESTA Futurelab
David Kester	November 2003		Creative Pioneer Programme
Anthony Lilley	March 2003	March 2006	NESTA Futurelab
Dr Stuart MacDonald	November 2003		Creative Pioneer Programme
Professor Angela McFarlane	March 2003	March 2006	NESTA Futurelab
Neil McLean	March 2003	March 2006	NESTA Futurelab
John Newbiggin	November 2003		Creative Pioneer Programme
Professor Jim Norton	March 2005	March 2006	NESTA Futurelab
Vince O'Brien	June 2004	June 2006	Invention & Innovation
Peter Orton	March 2003	March 2006	NESTA Futurelab
Colin Prescod	March 2004	March 2006	Learning
David Raitt	May 2003	June 2006	Fellowship
Paul Roberts	May 2004	June 2006	Fellowship
Jan Ryan	June 2005	June 2006	Fellowship
Gill Samuels	November 2004	June 2006	Fellowship
John Sorrell, CBE	November 2003		Creative Pioneer Programme
Helen Haste	January 2006	June 2006	Fellowship
Lynne Williams	January 2006	June 2006	Fellowship

As a result of the transfer of NESTA Futurelab to Futurelab Education (see Note 2 to the Accounts), the NESTA Futurelab Committee was dissolved in March 2006.

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.

Director's Report and Commentary continued

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 2006, 85% of undisputed invoices were paid within 30-days or the contractual term (2005: 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 communications 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 £324 (2005: £191) during the financial year.

NESTA's staff gave gifts totalling £195 (2005: £1,025) 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 chair during the financial year was Daniel Alexander. Other members of the Remuneration Committee were Tracy Long and Graham Ross Russell. A secretariat function is provided by the Chief Financial Officer and the Chief Executive, Deputy Chief Executive, Chief Financial Officer and HR Director normally attend.

The Remuneration Committee met four 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.

During this financial year the Remuneration Committee began to develop a robust framework for performance related pay. This work is ongoing. The new Chief Executive is entitled to a bonus under his contract based on meeting agreed objectives in line with Treasury guidelines.

Chairman, Trustees' & Committee Members' Remuneration

In accordance with paragraph 4 of schedule 4 of the National Lottery Act 1998, the Secretary of State for Culture, Media and Sport has determined that NESTA remunerate its Chairman, Trustees and Committee Members as follows:

- The Chairman is paid a salary of £24,814 (2005: £24,327) for two days per week.
- Trustees are paid an allowance of £202 (2005: £198) per day spent on NESTA business.
- Committee Members are paid an allowance of £163 (2005: £160) per day spent on NESTA business.
- Out-of-pocket expenses are recoverable.

For a list of all Trustees and Committee Members, refer to the Director's 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.

Remuneration Report continued

Executive Team Remuneration

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

	Salary & Benefits 2006 £'000	Bonus Payments 2006 £'000	Total 2006 £'000	Salary & Benefits 2005 £'000	Bonus Payments 2005 £'000	Total 2005 £'000	Employment Start Date	Employment End Date	Notice Period
Jeremy Newton	63 ¹	–	63	103	–	103	01-11-1998	10-06-2005	6 mths
Janet Morrison	90	–	90	75	–	75	01-03-1999		6 mths
Tom Hawkins	91	–	91	72	–	72	19-07-2004		6 mths
Phil Jones	69 ²	–	69	45	–	45	01-09-2004	31-10-2005	6 mths
Roger Gill	109 ³	–	109	20	–	20	17-01-2005	31-12-2005	6 mths
Jonathan Kestenbaum	60	5	65	–	–	–	01-11-2005		6 mths

- Benefits represent cash payments made under NESTA's flexible benefits scheme. They include childcare subsidy, enhanced benefits (health, learning and science, technology & arts related memberships) and pension/holiday flex. This scheme is available to all staff on the same terms.
- 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 2006 £'000	CETV at 31 March 2005 £'000	Real increase in CETV in year £'000
Jeremy Newton	–	10	68	64	4
Janet Morrison	2	7	33	23	10

- CETV is the cash equivalent transfer value.

Tom Hawkins, Roger Gill, Phil Jones and Jonathan Kestenbaum 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
25 October 2006

¹ Includes an amount for payment in lieu of notice and an ex gratia payment of £19k.

² Includes an amount for payment in lieu of notice.

³ Includes an amount for payment in lieu of notice.

NESTA Financial Statement 2005/06



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 the 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

25 October 2006

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.

As Chairman of the Board of Trustees, I have responsibility delegated from the Board of Trustees for satisfying myself and 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 being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place for the year ended 31 March 2006 and up to the date of approval of the annual report and accounts, and accords with Treasury guidance.

Capacity to handle risk

Under NESTA's Risk Management Framework, NESTA's Finance & Audit Committee are 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 "Management of Risk – Principles and Concepts" (the "Orange Book") issued by HM Treasury and related publications.

The Executive Team regularly review strategic risks, and individual members of the Executive Team are responsible for managing and monitoring these risks, where appropriate through their teams. Operational risk management is documented in operating manuals and communicated to staff through the induction and line management process. Policies are reinforced through the staff appraisal process and within the job descriptions of relevant staff.

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 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;
- Financial Directions issued by the Secretary of State under the National Lottery Act 1998, Government Accounting and other official sources include limits to and/or provide guidance concerning NESTA's range of activities and risk approach;
- Risk management has been incorporated into NESTA's strategic and business planning processes, with assessments of risk at the strategic, business plan and operating plan levels;
- 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;

Statement on Internal Control continued

- 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, mitigating factors and agreed actions and responsibilities for management. Key risks are reported to and discussed by the Trustees and Finance & Audit Committee;
- There is a system of codes of conduct, operating manuals, authorisation levels, separation of powers and other controls designed to ensure inter alia that potential conflicts of interest and fraud are identified and any resulting risks minimised;
- 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 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 and Audit Committee and Trustees in relation to risk management and internal control. In particular, this review has included the register of key organisational risks, quarterly monitoring reports to the Executive Team and 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.

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.

Significant Internal Control Problems

We have concluded that, although improvements to systems can always be made and NESTA has an ongoing programme to realise these, there have been no significant internal control problems during the year.

Jonathan Kestenbaum
Accounting Officer
25 October 2006

Chris Powell
Chairman
25 October 2006

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

I certify that I have audited the financial statements of the National Endowment for Science, Technology and the Arts (NESTA) for the year ended 31st March 2006 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.

Respective responsibilities of the Trustees, Chief Executive and auditor

The Trustees and Chief Executive 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 Trustees and Chief Executive'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 by the Secretary of State for Culture, Media and Sport, with the consent of HM Treasury. 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. I also report to you if, in my opinion, the Annual Report is not consistent with the financial statements, 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 relevant authorities regarding remuneration and other transactions is not disclosed.

I review whether the statement on pages 33 to 34 reflects NESTA's compliance with HM Treasury's guidance on the Statement on Internal Control, and I report if it does not. I am not required to consider whether the Accounting Officer's statements on internal control cover 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. This other information comprises only the Annual Report, including the unaudited part of the Remuneration Report. 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.

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

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 31st March 2006 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
- 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.

I have no observations to make on these financial statements.

John Bourn

Comptroller and Auditor General
National Audit Office
157–197 Buckingham Palace Road
Victoria
London SW1W 9SP
26 October 2006

The maintenance and integrity of the [entity's] website is the responsibility of the Accounting Officer; the work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Income and Expenditure Account

For the year ended 31 March 2006

	Notes	Continuing operations 2006 £'000	Discontinued operations 2006 £'000	Total 2006 £'000	Total 2005 £'000
Income					
Investment returns	3	17,133	86	17,219	15,133
Drawdown from Endowment	4	14,445	–	14,445	11,914
Other income	5	349	1,143	1,492	3,145
Total income		31,927	1,229	33,156	30,192
Expenditure					
Innovation Programmes	7(a)	12,037	2,431	14,468	13,267
NESTA Investments	7(a)	4,635	–	4,635	6,134
Policy & Research	7(a)	977	–	977	778
Communication	7(a)	1,867	–	1,867	1,744
Direct Support of Objectives		19,516	2,431	21,947	21,923
Corporate services	7(a)	2,696	–	2,696	2,318
Exceptional costs	7(b)	768	–	768	532
Total expenditure		22,980	2,431	25,411	24,773
Notional cost of capital		–	(18)	(18)	(23)
Net surplus after notional costs		8,947	(1,220)	7,727	5,396
Reversal of notional costs		–	18	18	23
Surplus for the year		8,947	(1,202)	7,745	5,419

There were no other gains or losses during the year.

The notes on pages 40 to 55 form an integral part of these financial statements.

Balance Sheet

At 31 March 2006

	Notes	2006 £'000	2005 £'000
Fixed assets			
Tangible fixed assets	8	493	1,015
Investments: Endowment	9	250,000	250,000
		250,493	251,015
Current assets			
Investments: Endowment	9	34,802	31,132
Other	9	20,766	17,047
Debtors	10	640	951
Cash at bank and in hand	18	873	1,215
		57,081	50,345
Current liabilities			
Creditors: awards falling due for payment within one year	11	5,354	6,055
other amounts falling due within one year	12	2,109	3,484
		7,463	9,539
Net current assets		49,618	40,806
Total assets less current liabilities		300,111	291,821
Creditors: awards falling due for payment after one year	11	1,552	1,670
Provisions and charges	13	228	120
Net assets		298,331	290,031
Represented by reserves			
Endowment reserve	19	276,532	275,977
Accumulated surplus	19	21,799	14,054
Total reserves		298,331	290,031

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 13 July 2006 and signed on their behalf by:

Jonathan Kestenbaum

Accounting Officer
25 October 2006

The notes on pages 40 to 55 form an integral part of these financial statements.

Cash Flow Statement

For the year ended 31 March 2006

	Notes	2006 £'000	2005 £'000
Net cash outflow from operating activities			
Payments of awards		(9,939)	(9,090)
Payments for staff and trustees' costs		(5,489)	(5,083)
Payments for other costs		(9,364)	(8,578)
Project funding		1,820	2,124
Transfer of project funding to Futurelab Education		(2,578)	–
Donations received		85	36
Other income		440	216
	20	(25,025)	(20,375)
Returns on investments			
Interest received		17,094	20,855
Capital expenditure and financial investment			
Payments to acquire tangible fixed assets		(163)	(644)
Receipts from disposal of tangible fixed assets		16	13
Increase in Endowment		15,000	–
Net proceeds from the (purchase)/sale of fixed asset investments		(44,948)	67,398
Decrease/(Increase) in short term deposits		37,400	(68,555)
		7,305	(1,788)
(Decrease) in cash	18	(626)	(1,308)

The notes on pages 40 to 55 form an integral part of these financial statements.

Notes to the Accounts

For the year ended 31 March 2006

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 Directions 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.

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.

As explained more fully in Note 9(a), 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 programme are not capitalised. Note 9(b) gives details of such investments.

Notes to the Accounts continued

For the year ended 31 March 2006

1 Accounting policies continued

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.

Pensions

The costs of all employer pension contributions are charged to the Income & 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% (2005: 3.5%) of the average non-lottery funded balances employed over the financial year.

Notes to the Accounts continued

For the year ended 31 March 2006

2 Continuing and discontinued operations (Futurelab)

In October 2005 the NESTA trustees approved in principle for the work currently being carried out by NESTA Futurelab to be taken forward by an independent organisation. Following this a company limited by guarantee, Futurelab Education, was set up and has become a registered charity (1113051). Futurelab Education applied for, and received, a grant from NESTA, to continue and expand the work previously carried out by NESTA Futurelab, as set out below. The grant consisted of £660k, and the net assets and ongoing business of NESTA Futurelab. The transfer of NESTA Futurelab's net assets to Futurelab Education had minimal impact on NESTA's net assets.

In accordance with FRS3, 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. Separate presentation will assist analysis of the significance of the transfer of NESTA Futurelab to NESTA's future operation.

	Continuing operations 2006 £'000	Discont'd operations 2006 £'000	Total 2006 £'000	Continuing operations 2005 £'000	Discont'd operations 2005 £'000	Total 2005 £'000
Income						
Investment returns	17,133	86	17,219	15,094	39	15,133
Drawdown from endowment	14,445	–	14,445	11,914	–	11,914
Other income	349	1,143	1,492	766	2,379	3,145
Total income	31,927	1,229	33,156	27,774	2,418	30,192
Expenditure						
Innovation Programmes	12,037	2,431	14,468	10,978	2,289	13,267
NESTA Investments	4,635	–	4,635	6,134	–	6,134
Policy and Research	977	–	977	778	–	778
Communication	1,867	–	1,867	1,744	–	1,744
Direct Support of Objectives	19,516	2,431	21,947	19,634	2,289	21,923
Corporate services	2,696	–	2,696	2,318	–	2,318
Exceptional costs	768	–	768	532	–	532
Total expenditure	22,980	2,431	25,411	22,484	2,289	24,773
Surplus for the year	8,947	(1,202)	7,745	5,290	129	5,419

A summary of the assets and liabilities transferred to Futurelab Education, in addition to the cash grant of £660k, is set out below:

	£'000
Intangible Fixed Assets at valuation	20
Tangible Fixed Assets: Cost	584
Accumulated depreciation	(508)
Cash	2,578
Deferred Income liability	(2,578)
Net Assets	96

Notes to the Accounts continued

For the year ended 31 March 2006

3 Investment returns

	2006 £'000	2005 £'000
Endowment:		
Gross interest receivable	15,496	18,547
Amortisation of redemption premium/discount	(3,187)	(5,874)
Adjustment to market value	861	179
Total returns	13,170	12,852
Other investments:		
Interest & dividends receivable	577	546
Capital gains	3,412	1,645
Total returns	3,989	2,191
Bank Interest	60	90
Total Investment Returns	17,219	15,133

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 (or discount) to nominal value. This inevitably gives rise to a capital loss (or 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.

Whilst the amortisation of the premium or discount is caused by the natural movement in bond prices as they reach maturity, 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 2006, cumulative gains due to adjustments to market value include £970k (2005: £331k loss) that will reverse in future years.

Included within amortisation of redemption premium and market value adjustment are realised capital losses of £2,037k and £632k respectively (2005: £3,461k and £1,024k). These losses were anticipated and are a natural consequence of NESTA's investment strategy.

Other investments

There were no realised capital gains or losses (2005: £90k loss).

4 Transfer from Endowment

NESTA is permitted to draw down limited funding from its Endowment as set out in Note 19. The £14,445k transfer represents the amounts used in this way (2005: £11,914k).

Notes to the Accounts continued

For the year ended 31 March 2006

5 Other income

		Continuing operations 2006 £'000	Discont'd operations 2006 £'000	Total 2006 £'000	Total 2005 £'000
Project Funding:	DfES	245	681	926	2,806
	DTI	64	7	71	101
	One North East RDA	33	–	33	–
Royalty income, loan interest & dividends from awards		4	13	17	(1)
Other income		3	442	445	239
Total other income		349	1,143	1,492	3,145

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

6 Staff costs

	2006 £'000	2005 £'000
Salaries and benefits	5,169	4,225
Social security costs	527	426
Pension contributions	518	412
	6,214	5,063
Trustees' remuneration	51	49
Total staff costs	6,265	5,112

Staff costs include £1,061k (2005: £860k) attributable to Futurelab. Redundancy and termination costs of £768k are not included above. Details are shown in Note 7(b). Further information on pensions is included in Note 17 and in the Remuneration Report.

Interest-free season ticket loans were available to all NESTA staff during the year. As at 31 March 2006, three senior managers and twenty seven 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 £7,206.

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

	Employees 2006	Agency/ contract staff 2006	Staff on secondm't 2006	Total 2006	Total 2005
Executive	4	–	–	4	3
Programmes	73	4	1	78	67
Corporate services	32	3	–	35	29
Strategy & communications	23	8	–	31	16
Total	132	15	1	148	115

Notes to the Accounts continued

For the year ended 31 March 2006

7 Expenditure

7(a) Expenditure by division

Expenditure has been classified in line with NESTA's new vision, mission and supporting structure. Comparative figures have also been reclassified.

Programmes and activities now closed are included within the appropriate division for the purposes of comparison.

Innovation Programmes

The Innovation Programmes division includes NESTA's programmes and activities supporting the human dimension of innovation.

In 2005 and 2006, this included the Fellowship, Learning and Creative Pioneer programmes, the Futurelab and Planet Science projects and the national and regional network activity.

Total expenditure for the year on continuing activities was £12,037k (2005: £10,978k).

NESTA Investments

NESTA Investments includes NESTA's investment and non-financial support programmes and activities supporting the financial dimension of innovation.

In 2005 and 2006, this included the Invention and Innovation Programme.

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

Total expenditure for the year on continuing activities was £4,635k (2005: £6,134k).

Policy and Research

Policy and Research covers NESTA's activities supporting the policy dimension of innovation.

Total expenditure for the year on continuing activities was £977k (2005: £778k).

Communication

Dissemination and communication of NESTA's work is a key aspect of its remit and an integral part of its strategy. Supporting and integrated with Innovation Programmes, NESTA Investments and Policy and Research, the Communication division includes all communications and web activity, competitions, events and sponsorship.

Total expenditure for the year on continuing activities was £1,867k (2005: £1,744k).

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 £2,696k (2005: £2,318k).

Notes to the Accounts continued

For the year ended 31 March 2006

7 Expenditure continued

7(b) Expenditure by type

	2006 £'000	2005 £'000
Investments (Invention & Innovation programme)	2,105	3,785
Learning programme projects	4,082	2,550
Planet Science	92	579
Fellowship grants	1,919	2,621
Creative Pioneer programme grants	1,109	836
Awardee training and academies	626	706
Mentoring and other direct support	490	742
Assessment, monitoring and other support	742	616
Communications and publicity	371	394
Web costs	308	398
Competitions and sponsorship	346	380
Research and publications	350	290
Staff costs (excluding Futurelab)	5,205	4,252
Recruitment and training	552	552
Travel, subsistence and hospitality	270	214
Agency staff costs	366	293
Consultancy and conference fees	482	112
Depreciation	521	500
Information technology costs	137	207
Office and sundry	715	429
Finance, investment fees, legal & audit fees	236	285
Operating leases: land and buildings	470	301
Irrecoverable VAT	718	910
Total Continuing and non-exceptional costs	22,212	21,952
Futurelab	2,431	2,289
Redundancy costs	519	–
Payments in lieu of notice	249	–
AIMS costs	–	532
Total Discontinued activities & exceptional costs	3,199	2,821
Total expenditure	25,411	24,773

7(c) Further information

	2006 £'000	2005 £'000
Net surplus is stated after charging:		
Auditor's remuneration	32	25
Staff travel, subsistence and hospitality	244	197
Trustee travel and subsistence	17	17

The auditor's remuneration was entirely for audit services. This includes costs attributable to the 2005/06 annual audit of £26.5k.

Notes to the Accounts continued

For the year ended 31 March 2006

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
Cost or valuation							
At 1 April 2005	1,578	384	1,007	238	373	39	3,619
Additions	–	86	53	10	11	3	163
Disposals	(321)	(111)	(50)	(116)	(57)	–	(655)
At 31 March 2006	1,257	359	1,010	132	327	42	3,127
Depreciation							
At 1 April 2005	1,080	225	857	165	277	–	2,604
Charge for the year	296	86	129	38	44	–	593
Disposals in year	(306)	(80)	(13)	(107)	(57)	–	(563)
At 31 March 2006	1,070	231	973	96	264	–	2,634
Net Book Value							
At 31 March 2006	187	128	37	36	63	42	493
At 31 March 2005	498	159	150	73	96	39	1,015

Leasehold improvements are in respect of the lease for Fishmongers' Chambers, which is for a period of seven years of which 6 months remain and St Magnus House, which is for a period of three years of which 1.4 years remain.

Assets have not been revalued at 31 March 2006 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.

£72k of depreciation relates to Futurelab assets. Disposals of £584k at cost and £508k of accumulated depreciation relate to the transfer of business to Futurelab Education. See note 2.

Notes to the Accounts continued

For the year ended 31 March 2006

9(a) Investments

In accordance with the National Lottery Act 1998, NESTA was provided with an Endowment of £310m in total. Up to £60m of this total was provided with permission to draw down funds from this capital sum to meet commitments and expenditure. 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.

In accordance with the National Lottery Act 1998 and the Financial Directions, NESTA invests the Endowment with the Commissioners for the Reduction of The National Debt in certain specified investments, essentially UK government bonds and cash. Other funds including any surplus income from the Endowment are invested separately by commercial investment managers.

	Cost 2006 £'000	Market value 2006 £'000	Cost 2005 £'000	Market value 2005 £'000
Cash and short-term deposits	35,650	35,916	73,041	74,223
Government & government-guaranteed stocks:				
Up to one year	44,231	41,043	32,197	30,499
Two to five years	209,786	207,843	180,174	176,410
Total Endowment	289,667	284,802	285,412	281,132
Cash and short-term deposits	–	–	292	386
UK equities	13,444	14,805	12,815	11,524
Property funds	4,653	5,961	4,653	5,137
Total other investments	18,097	20,766	17,760	17,047
Total investments	307,764	305,568	303,172	298,179

Of the Endowment, £250,000k is treated as a fixed asset investment and £34,802k (2005: £31,132k) as a current asset investment. All other investments are treated as current asset investments.

	Endowment 2006 £'000	Other 2006 £'000	Total 2006 £'000	Endowment 2005 £'000	Other 2005 £'000	Total 2005 £'000
Balance at 1 April 2005	281,132	17,047	298,179	288,005	14,995	303,000
Addition to Endowment	15,000	–	15,000	–	–	–
Investment returns	13,170	3,989	17,159	12,852	2,190	15,042
Transfer to cover expenditure	(24,500)	(270)	(24,770)	(19,725)	(138)	(19,863)
Balance at 31 March 2006	284,802	20,766	305,568	281,132	17,047	298,179

Notes to the Accounts continued

For the year ended 31 March 2006

Note 9(b) Seed & Early-Stage Investments

The Invention & Innovation programme has made equity, participating or convertible loan or quasi-equity investments in a portfolio of early-stage and start-up companies. In the early years of the programme, many transactions were closer in nature to a grant than an investment made with an expectation of a financial return. Excluding these, a summary of actively managed investments held at 31 March 2006 are set out below:

Investment at Cost Company	2006 £'000
Odontis Ltd	100
Imprint Pharmaceuticals Ltd	100
Bluegnome Ltd	100
Meciria	100
ROBAT Ltd	105
Ophthalmos Ltd	115
Orthogem Ltd	117
Dialog Devices	125
Surface Generation Ltd	125
Water Innovate Ltd	125
Starbridge Systems Ltd	133
Tideway Systems Ltd	147
St Andrews Fuel Cell Ltd	148
CellCentric Ltd	150
Micrima Limited	150
Haemostatix Ltd	150
Ceravision Ltd	150
CamFPD Ltd	150
IceRobotics Ltd	173
MMIC Solutions Ltd	180
Probe Scientific Ltd	191
Scyron Ltd	200
Quotient Diagnostics Ltd	211
Box Consultants Ltd	219
NanoSight Ltd	225
Hypertag Ltd	238
Veryan Medical Ltd	245
Symetrica Ltd	249
Advanced Transport Systems Ltd (ATS)	250
Ashe Morris Ltd	250
AquaPharm Bio-Discovery Limited	250
Colourholographic Ltd	254
Wright Fenn and Co. Ltd	258
	5,683
18 other investments of less than £100k	878
Total investment at cost	6,561

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 at 31 March 2006. 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. The valuation process has recently been adopted by NESTA and comparative figures for 2005 have not been produced.

Notes to the Accounts continued

For the year ended 31 March 2006

Note 9(b) Seed & Early-Stage Investments continued

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, valuations exceed costs only when a subsequent investment has been made by a third party at a higher valuation.

	2006 £'000
Investments	
Number of investments valued above cost	10
Number of investments valued at cost	22
Number of investments valued below cost	19
Total number of investments	51

10 Debtors

	2006 £'000	2005 £'000
Trade Debtors	394	889
Prepayments	170	62
Accrued income	76	–
Total debtors	640	951

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 (DfES and One North East RDA) of £206k (£200k and £6k respectively), exclusive of VAT.

11 Creditors: Awards

	At 1 April 2005 £'000	New Commitments £'000	Commitments Paid £'000	De-Commitments £'000	At 31 March 2006 £'000
Contracted commitments					
Invention and Innovation	1,423	2,423	(2,771)	(318)	757
Fellowship	3,567	1,924	(2,440)	(5)	3,046
Learning	2,427	4,162	(3,688)	(79)	2,822
Creative Pioneer programme	308	1,143	(1,136)	(34)	281
Total	7,725	9,652	(10,035)	(436)	6,906

Learning includes a grant of £756k to Futurelab Education committed and paid in the year. See also Note 2.

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
Invention and Innovation	757	–	–	–	–	757
Fellowship	1,910	804	294	38	–	3,046
Learning	2,406	331	85	–	–	2,822
Creative Pioneer programme	281	–	–	–	–	281
Total	5,354	1,135	379	38	–	6,906

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

Notes to the Accounts continued

For the year ended 31 March 2006

12 Creditors: Other amounts falling due within one year

	2006 £'000	2005 £'000
Trade creditors	206	191
VAT creditor	126	478
Other taxation and social security	164	143
Other creditors	2	27
Accruals and deferred income	1,611	2,645
Total creditors	2,109	3,484

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 are no creditor balances falling within this category.

13 Provisions and charges

Provisions for dilapidations on leasehold buildings	Fishmongers' Chambers	St Magnus House	Total	2005
At 1 April 2005	85	35	120	82
Additional provision in year	63	45	108	38
Utilisation of provision in year	–	–	–	–
At 31 March 2006	148	80	228	120

NESTA is due to relocate from the above mentioned premises in November 2006. The provisions made represent the costs of reinstatement work, repair work, redecoration and other specific works, as required by the terms of the leases. The costs provided for are based on visual inspection only and exclude VAT.

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 2005 £'000	Approvals £'000	Contracted £'000	Cancelled/ Withdrawn £'000	At 31 March 2006 £'000
Invention and Innovation	1,786	4,224	(2,423)	(1,306)	2,281
Fellowship	511	1,924	(1,924)	(244)	267
Learning	1,768	5,383	(4,162)	(474)	2,515
Creative Pioneer Programme	78	1,145	(1,143)	–	80
Total	4,143	12,676	(9,652)	(2,024)	5,143

15 Capital commitments

Amounts committed and contracted for in respect of capital expenditure:

	2006 £'000	2005 £'000
Computer systems	–	15

Notes to the Accounts continued

For the year ended 31 March 2006

16 Operating lease commitments

At 31 March 2006, NESTA had an annual commitment under operating leases as follows:

Land and Buildings:	Less than 1 year to expiry	1 – 5 years to expiry	More than 5 years to expiry	2,006 £'000	2,005 £'000
Fishmongers' Chambers, London	6 months			113	225
St Magnus House, London		1 year, 4.5 months		173	173
1 Canons Road, Bristol			11 years, 4 months	–	51
Scotswood Road, Newcastle Upon Tyne		4 years, 6 months		5	–
Other Leases:					
Photocopiers		5 years		19	–
Total				310	449

The 1 Canons Road, Bristol premises have a 15-year lease with a break clause every third year. Following the transfer of NESTA Futurelab to Futurelab Education, NESTA and the landlords have agreed heads of terms to surrender the lease, which will be formalised shortly.

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

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 £518k. As at the balance sheet date, there were outstanding contributions, again for all schemes, of £29k, which represents contributions due for the month of March 2006, payable in April 2006.

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. At that date the assets represented 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-eightieths 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.

Notes to the Accounts continued

For the year ended 31 March 2006

18 Analysis of net cash

	1 Apr 2005 £'000	31 Mar 2006 £'000	Movement £'000
At bank and in hand	1,215	873	(342)
Included in Investments	294	10	(284)
Total	1,509	883	(626)

19 Reserves

	Endowment reserve £'000	Accumulated surplus £'000	Total £'000
At 1 April 2005	275,977	14,054	290,031
Transfer from Endowment	(14,445)	–	(14,445)
Addition to Endowment	15,000	–	15,000
Surplus for the year	–	7,745	7,745
At 31 March 2006	276,532	21,799	298,331

Up to £26,532k (2005: £25,977k) of the Endowment reserve can be transferred by NESTA to cover commitments (in excess of £10m per annum) made up to 31 March 2007.

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

	2006 £'000	2005 £'000
Surplus for the year	7,745	5,419
Drawdown from Endowment	(14,445)	(11,914)
Investment returns	(17,219)	(15,060)
Depreciation	593	666
Non cash AIMS costs	–	229
Non cash grant of assets	76	–
(Increase)/Decrease in debtors	311	(112)
Increase/(Decrease) in awards contracted	(819)	712
(Decrease) in other creditors	(1,375)	(353)
Increase in provisions and charges	108	38
Net cash outflow from operating activities	(25,025)	(20,375)

Notes to the Accounts continued

For the year ended 31 March 2006

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 2006, £17,291k (52%) of NESTA's income derived from the returns accruing on its investments. The remaining income derived from a transfer from its Endowment of £14,445k (44%), and project funding and other income of £1,492k (4%).

NESTA is satisfied that it has sufficient certainty over future income and liquid resources in the form of cash of £873k and current asset investments of £55,568k 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, do pose potential risks to NESTA.

Interest Rate Profile

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

	Fixed rate £'000	Floating rate £'000	Non- interest bearing £'000	Weighted average interest rate %	Weighted average period for which rate is fixed
At 31 March 2006					
Fixed rate	283,531	–	–	4.43	2 years 0 months
Floating rate	–	2,144	–	4.27	
Non-interest bearing assets	–	–	20,766		
	283,531	2,144	20,766		
At 31 March 2005					
Fixed rate	281,127	–	–	4.54	1 year 8 months
Floating rate	–	1,512	–	4.25	
Non-interest bearing assets	–	–	16,755		
	281,127	1,512	16,755		

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.

Reconciled to the Account

	2006 £'000	2005 £'000
Fixed asset investments	250,000	250,000
Current asset investments	55,568	48,179
Cash at bank and in hand	873	1,215
Total	306,441	299,394

Notes to the Accounts continued

For the year ended 31 March 2006

21 Financial Instruments continued

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 Related parties

NESTA maintains publicly available registers in which Trustees, Committee members and members of staff declare their interests, including any direct interests in grant applications made to NESTA and commercial relationships with NESTA. Trustees, Committee members and members of staff also exclude themselves from the relevant application appraisals, discussions and approval processes.

The following related party transactions occurred during the period:

Organisation	Name	Relationship to recipient organisation	Transactions for the year ended 31 March 2006 £'000	Balance Outstanding at 31 March 2006 £'000
Trustees of NESTA				
Futurelab Education	Tom Bentley	Trustee	756	–
Committee members of NESTA				
DfES Innovation Unit (National Collaborative)	Felicity Gillespie	Consultant	290	62
The Lighthouse Trust	Stuart MacDonald	Executive Director	40	–
Cheltenham Science Festival	Gill Samuels	Chair	30	16
Famelab Competition	Gill Samuels	Judge	59	–
Employees of NESTA				
Access Art	Siobhan Edwards	Trustee	10	5
Artworks	Siobhan Edwards	Committee Member	10	–
John Brimacombe	Richard Hadden	Relative	3	–
Greenwich and Lewisham's Young People's Theatre	Rick Hall	Board Member	3	–
Hugo Morgan Williams	Mark White	Relative	7	–
British Business Angel Association	Mark White	Director	5	–

The Department for Culture, Media and Sport, the Department for Education and Skills, the Department for Trade and Industry and the Commissioners for the Reduction of the National Debt are all regarded as related parties. Transactions with these bodies are disclosed within the accounts. Adrian Hall, NESTA Futurelab committee member and a family member of Phil Jones, Learning Executive, are employees of the DfES.

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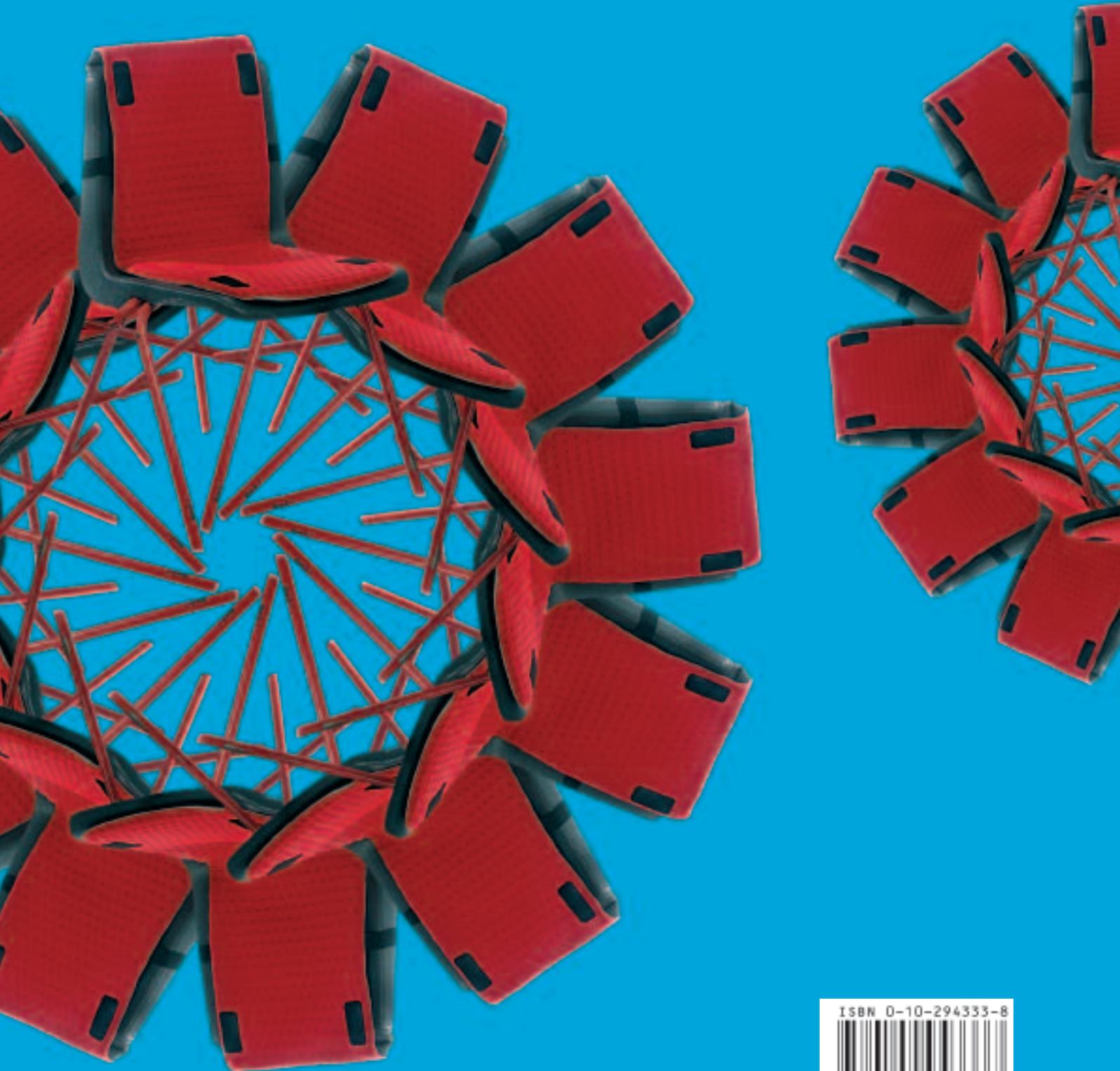




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