

# Annual Report and Accounts

For the year ended 31 March 2008





# NESTA Annual Report and Accounts 2007/08

Annual Report presented to Parliament by the Secretary of State for Innovation, Universities and Skills pursuant to section 22(5) of the National Lottery Act 1998.  
Accounts for the year ended 31 March 2008 presented to Parliament by the Secretary of State for Innovation, Universities and Skills on behalf of the Comptroller and Auditor General pursuant to section 23(4) of the National Lottery Act 1998.

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## About NESTA

NESTA is the National Endowment for Science, Technology and the Arts – a unique and independent body with a mission to make the UK more innovative. We invest in early-stage companies, inform and shape policy, and deliver practical programmes that inspire others to solve the big challenges of the future.

The unique nature of our endowed funds means that we are able to act differently from others. It allows us to take a longer-term view, and develop ambitious models of innovation that others can replicate or adapt. Our independence and ability to work across different sectors means that we are able to bring together ideas from a wide range of perspectives, and to assume a greater burden of risk than others.

NESTA does not work alone. Our success depends on the strength of the partnerships we form with innovators, policymakers, community organisations, educators and other investors. We bring the best ideas, new flows of capital and talented people together, and encourage others to develop them further.

### The year in review: 2007/2008

This report is divided into two parts. The first is a review of 2007/08 (pages 6 to 10), divided into NESTA's three primary areas of activity: Innovation Programmes; Policy and Research; and Investments. The second part (pages 11 to 44) contains the Financial Statements 2007/08, including the Directors' Report and Management Commentary.

This report is complemented by NESTA's Annual Review, published in February 2008, which contains details of NESTA's activities during the calendar year 2007. It can be downloaded (along with previous Annual Reports) from the NESTA website at [www.nesta.org.uk/annual-reports](http://www.nesta.org.uk/annual-reports).

### Plans for 2008/09

In 2008/09 NESTA will be delivering a series of targets and outcomes based around its four Corporate Goals:

**Goal 1:** Establish NESTA as a renowned centre of expertise in innovation.

**Goal 2:** Build well-evidenced models of how innovation can work.

**Goal 3:** Have NESTA's models adopted by others.

**Goal 4:** Make NESTA a highly effective and sustainable organisation.

The key concept here is that of a 'model', which we define as a group of related insights about an issue which can be understood and copied.

By the end of 2008/09, we will have:

- three models formed and ready for replication;
- initial learnings from a further ten models; and
- a further four new models at the planning stage

In addition, building on our contribution to the 'Innovation Nation' White Paper, we aim to:

- gain acceptance by Government Departments and other major stakeholders of NESTA's design for the UK's new Innovation Index;
- in partnership with DIUS, the Economic and Social Research Council (ESRC) and the Technology Strategy Board, establish an Innovation Research Centre; and
- establish a Public Services Innovation Laboratory.

## Innovation Programmes

Innovation thrives when talented people with creative ideas are given the right support, stimulation and incentives. NESTA's Innovation Programmes are designed to find out – through building and testing different innovation models – the best ways to make that happen.

During 2007/08, we developed a range of programmes focusing on four main areas of interest: collaborative innovation; the creative economy; social innovation and finance; and young people and innovation.

### Collaborative innovation

NESTA is experimenting with different approaches to collaborative working – putting people and organisations together in unusual combinations to spark new ideas and new perspectives on old problems.

**Planned for 2007/08 (as stated in the NESTA Annual Report 2006/07):** Launch and develop NESTA Connect.

We launched NESTA Connect in June 2007, with the aim of establishing a portfolio of partnership projects exploring themes of: interdisciplinary research; corporate open innovation; and building innovation communities on- and off-line.

Programmes developed during the year included the **P&G Open Innovation Challenge** (September 2007),

in collaboration with Procter & Gamble, and **Corporate Connections** (October 2007), a series of collaborative workshops with companies such as Eon, McLaren Applied Technologies, Philips and Virgin Atlantic.

**Planned for 2007/08:** Launch Crucible 2007.

**Crucible 2007** (launched March 2007) brings together 30 early-career researchers from a wide variety of science and social science backgrounds to develop new collaborations across disciplines, and explore the wider potential of their work.

**Planned for 2007/08:** Pilot an interdisciplinary incubator at Design London.

Design London (created July 2007) is an interdisciplinary centre of excellence in design, engineering, technology and business which was developed during the course of the year in partnership with Imperial College, the Royal College of Arts, and Tanaka Business School.

Other Connect projects have looked at various forms of interdisciplinarity, including knowledge exchange in imaging, interdisciplinary innovation in universities, and customer interfaces in music.

## Creative economy

Creative businesses are by definition good at creativity. And they are vitally important – both culturally and economically – to the UK. But they face specific challenges. Research by NESTA and others has highlighted that many creative businesses face specialised barriers to growth and business innovation. They also tend to operate in sectors that are sensitive to rapid and disruptive change.

NESTA's Creative Economy portfolio is developing a series of pilots to demonstrate how creative organisations can develop their business innovation capacity to drive growth.

**Planned for 2007/08:** Continue to test and roll out business development techniques for early-stage creative businesses.

**Insight Out Wales** (launched March 2007) is a partnership between NESTA and the Welsh Assembly Government's Creative Business Wales team. It brings to seven the number of UK nations and regions that have successfully piloted the Inside Out model.

**Starter for 6** (further developed during 2007/08) is a new-enterprise development programme in Scotland that provides training and support to help establish or further develop fledgling, innovative businesses.

**Planned for 2007/08:** Develop effective models of support for innovators, to encourage growth in the creative industries.

**Digital Innovation in Film** (launched March 2008) is a new initiative from NESTA and the UK Film Council, which will help drive growth in British independent film companies by encouraging them to take better advantage of new technologies.

**The London Fashion Designer Economy Research** (launched March 2008): a project to identify the barriers to growth in the fashion design sector.

## Social innovation and finance

The UK's most significant social challenges – such as those associated with an ageing population and environmental sustainability – are resisting conventional solutions. New approaches, based on finding and successfully scaling social innovations, are required.

During 2007/08, NESTA further developed its portfolio of practical experiments designed to understand and accelerate social innovation.

**Planned for 2007/08:** Launch the Environment Challenge.

We launched our focus on the environment – a cluster of projects relating to the environment and climate change – in July 2007. We are particularly interested in innovative approaches to encouraging behavioural change around these important issues.

Programmes developed during the year included the **Big Green Challenge** (October 2007) – a £1 million prize fund to encourage community-level innovation – and the **Lowestoft Energy Challenge** (May 2007).

**Planned for 2007/08:** Continue to develop the Health Challenge.

**Health Innovation Accelerator** (now renamed the Health Launchpad; launched March 2007) is an early-stage social venture fund, developed in partnership with The Young Foundation, which aims to transform promising ideas relating to long-term conditions into new ventures by providing financial support, time and expertise.

**Innovations in Mental Health** (launched March 2007) is designed to demonstrate how to stimulate local ideas that, with the right support and guidance, have the potential to grow successfully into national projects with real impact.

We have also developed projects on design and social challenges, and begun work on creating risk capital for social enterprises.

### NESTA Public Services Innovation Laboratory (announced March 2008):

Our proposal for setting up a Public Services Innovation Laboratory was announced in the DIUS White Paper, 'Innovation Nation' published in March 2008. The Lab will build on the work of NESTA's Challenge programme and will establish a dedicated facility for accelerating solutions to the complex problems threatening societal well-being and economic competitiveness.

## Young people and innovation

Increasing the UK's capacity for innovation in the future means engaging today with the innovators of tomorrow. An important part of NESTA's work focuses on developing from an early age the innovative skills and attitudes – creativity, adaptability, teamwork and an informed view of risk – that underpin successful innovation.

**Planned for 2007/08:** Formally launch Future Innovators.

We launched the Future Innovators strand of work in April 2007.

**Planned for 2007/08:** Build our portfolio of pilot projects, and test new models.

We launched a range of projects, including studies to explore ways in which businesses can work effectively with education providers to help young people to develop the skills and attitudes necessary to succeed in the future workplace. We also launched a research project to explore the views of 16-17 year olds on how best to prepare young people for future work and careers.

Programmes developed during the year included **Planet SciCast** (April 2007), a science-focused project (linked to the ongoing **Planet Science** web-based programme) that challenges people to make mini films of exciting science experiments.

**Planned for 2007/08:** Build our portfolio of strategic partnerships, to implement successful approaches.

We established partnerships with Kingston University, Space Unlimited, RSA, Princes Trust, and Rotherham Ready, among others.

**Planned for 2007/08:** Develop our programme of events and competitions.

**Making a Mint** (annual) is a competition, held from November to July, which encourages young people to

use their entrepreneurial skills to grow mint seeds and come up with creative ideas to make money from them.

## NESTA Policy & Research Unit

NESTA aims to shape innovation policies that will help the UK meet the national innovation challenges of the 21st century. We use our expert knowledge to influence government and regulatory policy, and work with our Investments and Programmes teams to consider how policy might best support their work.

During 2007/08, the NESTA Policy & Research Unit (NPRU) continued to build on its reputation as an intellectual catalyst for UK innovation, with an emphasis on the following three areas of activity:

### 1. Increasing the quality and quantity of research in innovation.

We are achieving this by doing our own research and commissioning targeted research from leading academic and policy institutes.

### 2. Developing outstanding innovation policy.

We are using our research and unique position in the UK policy environment to develop and promote a strong pro-innovation policy agenda across the UK.

### 3. Building a national network of leading thinkers in innovation.

Developing policies that will transform the UK's ability to innovate isn't a solitary activity. It occurs when leading policy thinkers collaborate and form connections with centres of excellence in innovation policy. NESTA has a unique role to play in making this happen – we act as a 'hub' around which others can gather to exchange ideas and share experience.

## Outputs and areas of research

**Planned for 2007/08:** Three substantive areas of focus – we will concentrate most of our activities on hidden innovation, the role of 'place' in innovation, and the arts and innovation.

We issued ten research reports (and accompanying policy briefings) on these themes, notably:

**'Hidden Innovation'** (June 2007): a detailed look at six sectors (including retail banking and construction) that are not usually regarded as being highly innovative – at least according to traditional measurements. It reveals the significant amounts of innovation taking

place in these sectors and the considerable value that they create.

**‘Rural Innovation’** (December 2007): a series of essays examining the social, economic and technological changes that are affecting rural areas and what these changes mean for innovation.

**‘Creating Innovation’** (February 2008): presents the results of major new research into the role of the creative industries in stimulating and supporting innovation in the UK.

We also issued research reports, policy briefings and Provocations around other key themes:

**Innovative People:** to increase the UK’s capacity to innovate, we need to develop the innovative skills and attitudes of people – specifically young people and those currently in the education system.

**Social Innovation:** the phrase ‘social innovation’ has become popular with politicians and investors around the UK. As a concept though, it is poorly understood and tends to happen in isolated pockets, if at all. It can be deceptively simple to describe: it’s innovation for the public good. However, the issues that social innovation attempts to address are far from simple.

**Understanding Innovation:** To shape policies that will put the UK at the forefront of innovation, policymakers need to be given accurate and relevant assessments of the national state of innovation. We’re particularly interested in looking at sectors of the economy and society that are currently neglected by traditional innovation policy, and the challenges faced by innovative early-stage businesses. We’ll use our research to build a body of evidence about how best to support, measure and improve the UK’s climate for innovation.

### Innovation Index

In the DIUS White Paper, ‘Innovation Nation’, published in March 2008, John Denham, the Secretary of State for Innovation, Universities and Skills, charged NESTA with the responsibility to produce “a new Innovation Index to measure the UK’s performance as an Innovation Nation”.

We take this responsibility very seriously. The Index must be rigorous, accurate and inclusive. We hope that over time it will set a new international standard for the measurement of innovation.

The intellectual task is not one that NESTA can or should undertake alone, so we’ve begun a process of detailed planning and consultation.

### Innovation Research Centre

The DIUS White Paper also tasked NESTA, the Economic and Social Research Council (ESRC) and the Technology Strategy Board with establishing an Innovation Research Centre. The Centre will provide a supply of high quality innovation research into the innovation policy community.

## NESTA Investments

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

**Planned for 2007/08:** Invest in the most promising businesses in the early-stage sector.

### NESTA Ventures

NESTA Ventures invests directly in early-stage companies in Engineering, Environmental Technology, Healthcare, and Information and Communications Technology.

Our evergreen fund is around £5m per annum, building to £25m over five years. We invest approximately £250,000 as a first-round investment in each company, with the ability to participate in subsequent rounds. We can also act as a lead investor. In exceptional circumstances, we can provide follow-on investment to existing portfolio companies, beyond this level.

In 2007/08, we completed 14 follow-on investments, and made seven new direct investments.

### NESTA Capital

NESTA Capital invests in early-stage funds as a limited partner or co-investor, or as a cornerstone investor. Our main objective is to demonstrate successful, replicable models of investment to attract other sources of finance into the early-stage investment arena. Therefore, the ability to generate commercial levels of financial return is important to us.

We’re interested in investment proposals from companies that specialise in a range of industries and regional locations, where the management team can demonstrate a successful track record. Each year we

aim to make two or three investments, ranging from £1-3 million.

#### **IP Venture Fund**

In August 2007, IP Group plc, the intellectual property commercialisation company, announced that it had completed a second closing of the IP Venture Fund, attracting total commitments of £31 million with new investors, including NESTA. Managed by Top Technology Ventures Limited (the venture capital fund management subsidiary of IP Group), it commits in the region of 25 per cent of the amount of post-seed financings of IP Group portfolio companies alongside capital committed by external investors. It has completed nine investments in IP Group portfolio companies to date.

#### **Seedcamp**

In October 2007, we announced funding of €200,000 to support Seedcamp, an intensive programme designed to help a new generation of entrepreneurs to start businesses across Europe, the Middle East and Africa.

#### **UMIP Premier Fund**

At the start of April 2008, we announced funding of £3.5m in the UMIP Premier Fund, Europe's largest institutional fund with a single university focus. It invests in businesses emerging from the University of Manchester's academic departments. The fund has a broad range of UK and European institutional and supranational investors, including EIF (European Investment Fund), NESTA, Co-operative Insurance Society and others. A first close of €42m (£32m) is likely to be followed by a second close, to take the fund to a maximum size of €65m (£50m). Once it is fully invested, the fund is expected to comprise a portfolio of approximately 20 investments.

#### **Pentech Ventures**

Pentech Ventures is one of the UK's leading early-stage software funds, investing in software companies in the UK and Ireland with global, high-growth potential. In 2007/08, NESTA contributed to Pentech's second fund, Pentech II, which recently announced a first round closing of £32.2 million.

**Planned for 2007/08:** Revise our business support offering for our portfolio companies.

During 2007/08 we continued to develop non-financial support as a fundamental part of our investments model. We use a range of activities and methodologies, including: mentoring and management; training and networking; expertise; and collaborative business support projects.

# Directors' Report and Management 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 on pages 12 to 13.

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. In June 2007 sponsorship responsibility for NESTA passed to the Department for Innovation, Universities and Skills (DIUS). NESTA prepares its financial statements 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 Operating Officer.

## Statutory objects

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

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

- helping talented individuals (or groups of such individuals) in the fields of science, technology and the arts to achieve their potential;
- helping persons to turn inventions or ideas in the fields of science, technology and the arts into products or services:

- which can be effectively exploited; and
- the rights to which can be adequately protected; and
- contributing to public knowledge and appreciation of science, technology and the arts.

## Overview of developments

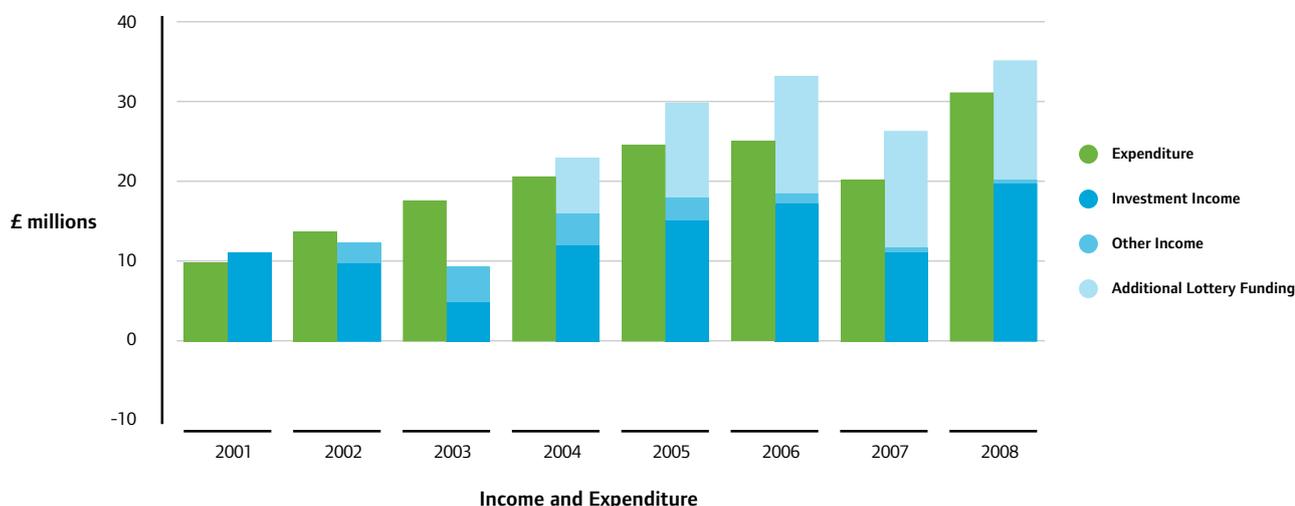
In 2007/08 NESTA launched a wide range of projects, building and testing different models of innovation to find out the best way to make innovation happen in practice. The projects operate in four main areas: the creative economy; collaborative innovation; social innovation and finance; and young people.

NESTA also played a substantial role in influencing innovation policy during the year. Its base was a substantial output of both in-house research and targeted research commissioned from academics, which enabled it to play an important and influential part in influencing the policy debate leading up to the production of the Government's White Paper 'Innovation Nation'. It also strengthened the national network of leading thinkers in innovation, which the organisation began to build the previous year, by acting as a 'hub' around which others could gather and exchange ideas.

In addition, NESTA made 14 follow-on investments and seven new direct investments in early-stage companies, totalling £3m in value. It also committed to four investments in early-stage funds totalling £7.1m.

## Financial overview

The financial statements on page 22 show the income, expenditure and surplus for the year. These are summarised in the graph with comparative figures for previous years.



As forecast in last year's annual report, activity increased considerably after a period of restructuring and refocusing of NESTA's activities. In particular, NESTA Investments activity increased substantially as the new investments team was able to deliver a full year's investment activity. Under NESTA's existing accounting policies this activity is treated as expenditure rather than being capitalised.

The ratio of support services costs to continuing non-exceptional expenditure fell from 13% last year, to 8.6% this year as programme activity increased, as well as the year-on-year total spend on support services falling.

Investment income is primarily interest on the Endowment, including any surplus income. Total Endowment and other assets at 31 March 2008 were £321m. Of this, £300m is the Endowment invested in gilts and cash, held with the Commissioners for the Reduction of the National Debt (CRND). Other investments are held in UK equity and property funds. During the year NESTA was required by its Financial Directions to invest its core Endowment in

gilts. This approach substantially limited the returns which the Endowment could generate. DIUS has now agreed to a liberalisation of this regime, and during 2008/09 NESTA will be investing its Endowment in a broader range of assets with a view to improving returns while limiting volatility through appropriate diversification. A separate Endowment Committee has been convened in 2008/09 to oversee the investment of the Endowment.

In the latter half of the 2007/08 year, some £78.5m of the Endowment investment held in gilts matured, and is now held as cash in the CRND's on-call interest-bearing account in readiness for reinvestment following the liberalisation of the Endowment investment policy.

NESTA will continue to receive additional lottery funding of £15m per year up to and including 2010/11 from the National Lottery in line with a Ministerial agreement in February 2006. Over the course of 2008/09 the organisation will be developing strategic options for beyond 2010/11.

## Organisational structure

Name	Position
Chris Powell	Chairman
Jonathan Kestenbaum	Chief Executive and Accounting Officer

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

Name	Date Appointed	Date Resigned	Position
Helen Gresty	May 2006		Executive Director Innovation Programmes
Richard Halkett	June 2006		Executive Director Policy & Research
Tom Hawkins	July 2004	April 2007	Chief Financial Officer
David Hunter	June 2006		Managing Director NESTA Investments
Daniel Oppenheimer	September 2007		Chief Operating Officer
Michael Stephenson	November 2007		Executive Director Communications

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

Name	Date Appointed	Date Retired	Committee Membership
Chris Powell (Chairman)	October 2003		Investment (Chair)
Sir Michael Barber	February 2006		Innovation Programmes (Chair)
Professor Marc Clement	July 2006		Investment
Dr Stuart Cosgrove	October 2004		
Sherry Coutu	May 2006		Investment, Endowment
Andrew Flanagan	February 2006		Finance & Audit (Chair)
Jitesh Gadhia	July 2007		Finance & Audit, Endowment (Chair)
Professor Julia Goodfellow	January 2005		
Dr Tracy Long	December 2003		Finance & Audit
Patrick McKenna	January 2007		Endowment
Professor William Morris	January 2004	January 2008	
Graham Ross Russell	November 2001	October 2007	Finance & Audit
Nick Starr	December 2007		Innovation Programmes
Professor Kathy Sykes	January 2007		Innovation Programmes

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

Name	Date Appointed	Date Retired	Committee
William Roe	August 2006		Innovation Programmes
David Auckland	August 2006		Innovation Programmes
Paul Roberts	July 2006		Innovation Programmes
Tom Hadfield	August 2006		Innovation Programmes
Madeleine Atkins	May 2007		Innovation Programmes
Ernie Richardson*	November 2006		Investment
Adrian Beecroft	December 2006		Investment
Ian Mclsaac	November 2006		Investment
Anthony Thomas	January 2008		Finance & Audit
Mikael Breuer-Weil	May 2008		Endowment

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

## Creditors

It is NESTA's policy to abide by the DTI's 'Better Payment Practice Code' and in particular to pay bills in accordance with contract terms. For the year ended 31 March 2008, 87% of undisputed invoices were paid within 30 days or the contractual term (2007: 85%).

## Equal opportunities

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

## Employee consultation

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

## Post Balance Sheet events

On 31 March 2008, the Secretary of State for the Department for Innovation, Universities and Skills gave permission for NESTA's investment policy to be liberalised. In previous years, NESTA's investment policy was to hold core Endowment in government gilts. From 2008/09 NESTA will be investing its Endowment in a broader range of assets with a view to improving returns while limiting volatility through appropriate diversification.

The financial statements were authorised for issue by the Board on 11 July 2008, the date the accounts were certified by the Comptroller & Auditor General.

There are no other 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 £342 (2007: £126) during the financial year.

NESTA's staff gave gifts totalling £1,156 (2007: £2,258) during the financial year.

## Audit information

As far as the Accounting Officer is aware, there is no relevant audit information of which NESTA's auditors are unaware, and the Accounting Officer has taken all the steps that he ought to have taken to make himself aware of any relevant audit information and to establish that NESTA's auditors are aware of that information.

# Remuneration Report

## Remuneration Committee

The Remuneration Committee is a sub-committee of the Board of Trustees and is incorporated into the Finance & Audit Committee. It consists of non-executive Trustees, all of whom are appointed on terms agreed by the Trustees.

The Remuneration Committee was chaired by Andrew Flanagan. Other members of the Remuneration Committee were Dr Tracy Long and Jitesh Gadhia (his first Committee was September 2007). Graham Ross Russell was also a member, but his last Committee was September 2007. A secretariat function is provided by the Chief Operating Officer, and the Chief Executive, Chief Operating Officer and the Head of Human Resources normally attend. The Remuneration Committee met four times during the year.

The Remuneration Committee's role is to:

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

The Remuneration Committee implemented a long-term framework for pay and reward following a partial introduction last financial year, and has agreed NESTA's first Human Resources Strategy for implementation in 2008/09. This work is ongoing.

## Chairman, Trustees' and Committee Members' remuneration

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

- The Chairman is paid a salary of £25,480 (2007: £25,310) for two days per week.
- Trustees are paid an allowance of £209 (2007: £208) per day spent on NESTA business.
- Committee Members are paid an allowance of £168 (2007: £167) per day.
- Out-of-pocket expenses are recoverable.
- There are no pension contributions made in respect of Trustees or Committee Members.

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

### Audited information:

## Executive team remuneration

The salary and allowances for the Executive team are listed on page 16.

- Benefits represent cash payments made under NESTA's flexible benefits scheme. They include childcare subsidy, enhanced benefits (health, learning and science, technology and arts related memberships) and pension/holiday flex.
- No member of the Executive team received any non-cash benefits (benefits in kind).
- All Executive appointments are on a permanent basis.
- Executive team salaries have been benchmarked against appropriate external markets. The salary for the Chief Executive was re-benchmarked during the year by an external assessor.
- Bonuses for the Executive team are based upon performance against defined objectives.

Jonathan Kestenbaum, Helen Gresty, Richard Halkett, Tom Hawkins, David Hunter, Daniel Oppenheimer and Michael Stephenson 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. The value of the Cash Equivalent Transfer Value at year-end has not been obtained for cost/benefit reasons.

	Salary & Benefits 2008 £'000	Pension Contributions £'000	Bonus Payments £'000	Total 2008 £'000	Salary & Benefits 2007 £'000	Pension Contributions £'000	Bonus Payments £'000	Total 2007 £'000	Employment Start Date	Employment End Date	Notice Period Months
Jonathan Kestenbaum	157	19	32	208	111	13	24	148	01/11/2005		3
Helen Gresty	84	10	8	102	66	8	6	80	01/06/2004		6
Richard Halkett	84	10	8	102	52	6	8	66	22/06/2006		3
Tom Hawkins	76 <sup>1</sup>	6	-	82	85	10	9	104		06/04/2007	
David Hunter	118	-	22	140	87	-	21	108	05/06/2006		1
Janet Morrison	-	-	-	-	120 <sup>2</sup>	-	10	130		31/07/2006	
Daniel Oppenheimer	47	7	4	58	-	-	-	-	03/09/2007		6
Angela Salt	-	-	-	-	118 <sup>3</sup>	8	-	126		31/03/2007	
Michael Stephenson	33	4	2	39	-	-	-	-	19/11/2007		6

1. This amount includes payment in lieu of notice and a contractual payment of £24k.

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

3. Includes an amount for payment in lieu of notice.

### Jonathan Kestenbaum

Accounting Officer

9 July 2008

# 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. In June 2007 sponsorship responsibility for NESTA passed to the Department for Innovation, Universities and Skills. The financial statements 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 financial statements, 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, 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 Innovation, Universities and Skills 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 *Managing Public Money* 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

**9 July 2008**

## Statement on Internal Control

### Scope of responsibility

As Accounting Officer I am responsible for maintaining a sound system of internal control that supports the achievement of NESTA's policies, aims and objectives, while safeguarding the public funds and assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Managing Public Money. I am accountable to the Secretary of State for Innovation, Universities and Skills and to Parliament for ensuring that NESTA distribute their funds with due regularity and propriety and to the Board of Trustees for the economic, efficient and effective use and control of their funds.

The Board of Trustees is responsible for ensuring that through appropriate procedures, systems and personnel, proper financial management and control is achieved.

### 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 NESTA's goals. It can therefore provide only 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 goals, to evaluate the likelihood of those risks materialising and their consequent impact, and to manage them efficiently and with appropriate and proportionate controls. The system of internal control has been in place at NESTA for the year ended 31 March 2008 and accords with Treasury guidance.

### Capacity to handle risk

NESTA's Chief Operating Officer has lead responsibility at the level of the Executive team for the risk management framework. NESTA's Finance & Audit Committee is responsible for monitoring the implementation of this framework, and for reviewing and reporting to the Board of Trustees annually on the approach to risk management.

The Executive team regularly reviews strategic risks, and individual members of the Executive team are responsible for managing and monitoring these and other operational risks, where appropriate through their teams. Staff actively consider risks as part of the management of individual projects.

## The risk and control framework

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

The Trustees believe that NESTA's mission requires it to have an element of risk-taking in its activities if it is to succeed. Accordingly NESTA's risk appetite is for managed risk-taking rather than simple risk aversion. This includes the recognition that some activities or projects may fail to a greater or lesser extent, and that such failure can be an important source of learning.

Risk management is incorporated into NESTA's strategic and business planning processes.

A budget and budget monitoring system is set in the context of a multi-year strategic planning process. The budget is approved by the Board of Trustees and quarterly financial reports are made to the Finance & Audit Committee.

NESTA's risk management framework sets out the basis for identifying, monitoring and reporting on risk in the context of the organisation's agreed risk appetite. Risk registers are maintained and regularly updated throughout the year as a result of executive and management reviews. Risks are discussed by the Finance & Audit Committee.

NESTA has a number of operational policies under the general headings of governance, financial controls and workplace management. These policies are supported by induction training designed to ensure that NESTA staff are aware of these policies and comply with them appropriately. There is special focus on the proper procurement of goods and services, the management of conflicts of interest and the control of fraud.

NESTA has an internal audit service which operates in accordance with Government Internal Audit Standards. The annual internal audit plans are informed by the risk register, are endorsed by the Finance & Audit Committee and approved by the Accounting Officer. The internal auditors provide an annual report on internal audit activity, an independent opinion on the adequacy and effectiveness of NESTA's system of internal control and recommendations for improvement. All internal audit reports and reviews are considered by the Finance & Audit Committee. Management responses and progress against agreed actions are reported to and monitored by the Finance & Audit Committee on a quarterly basis with an annual review of all outstanding matters. In keeping with best practice, NESTA periodically reviews its internal audit advisers. During the year, Grant Thornton were appointed as internal auditors.

The Finance & Audit Committee has three Trustee members and a co-opted member who has been selected for his/her effectiveness and experience in this field. Each meeting of the Committee includes an opportunity for a session with internal and external auditors without NESTA staff present.

## Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within the organisation 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 result of my review of the effectiveness of the system of internal control by the Board, and the Finance & Audit Committee, and a plan to address weaknesses and ensure continuous improvement of the system is in place.

I have reviewed the work and reports of the internal auditors and system of monitoring and 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, and have satisfied myself as to its soundness.

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

**Jonathan Kestenbaum**

Accounting Officer

**9 July 2008**

# 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 31 March 2008 under the National Lottery Act 1998. These comprise the Income and Expenditure Account, the Balance Sheet, the Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

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

The Trustees and Chief Executive as Accounting Officer are responsible for preparing the Annual Report, which includes 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 Innovation, Universities and Skills, with the consent of HM Treasury, and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's Responsibilities.

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

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

In addition, I report to you if NESTA has not kept proper accounting records, if I have not received all the information and explanations I require for my audit,

or if information specified by HM Treasury regarding remuneration and other transactions is not disclosed.

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

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

## Basis of audit opinion

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

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

## Opinions

In my opinion:

- the financial statements give a true and fair view, in accordance with the National Lottery Act 1998 and directions made thereunder by the Secretary of State for Culture, Media and Sport, with the consent of HM Treasury, of the state of NESTA's affairs as at 31 March 2008 and of its surplus, total recognised gains and losses and cashflows 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 Innovation, Universities and Skills, with the consent of HM Treasury; and
- the Directors' Report and Management Commentary included in the Annual Report, is consistent with the financial statements.

## Opinion on Regularity

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

## Report

I have no observations to make on these financial statements.

**T J Burr**

Comptroller and Auditor General

**11 July 2008**

**National Audit Office**

151 Buckingham Palace Road

Victoria

London

SW1W 9SS

## Income and Expenditure Account

For the year ended 31 March 2008

	Notes	Total 2008 £'000	Restated Total 2007 £'000
<b>Income</b>			
Investment returns: Endowment	3	13,519	12,671
Adjustment to market value	3	8,250	(4,068)
		21,769	8,603
Investment returns: Other	3	(1,861)	2,738
Lottery funding		15,000	15,000
Other income	4	666	248
<b>Total income</b>		<b>35,574</b>	<b>26,589</b>
<b>Less expenditure</b>			
Innovation Programmes	6	9,235	9,171
NESTA Investments	6	12,102	3,824
Policy & Research	6	3,679	1,273
Communications, events and public affairs	6	3,845	3,439
<b>Direct support of objectives</b>		<b>28,861</b>	<b>17,707</b>
Corporate Services	6	2,710	2,824
<b>Total expenditure</b>		<b>31,571</b>	<b>20,531</b>
Notional cost of capital		(3)	(4)
<b>Net surplus after notional costs</b>		<b>4,000</b>	<b>6,054</b>
Reversal of notional costs		3	4
<b>Surplus for the year</b>		<b>4,003</b>	<b>6,058</b>

There were no other gains or losses during the year. The effect of the prior period adjustment (refer Note 2) on the recognised gains and losses of NESTA, are nil.

There are no discontinued activities.

The notes on pages 25 to 44 form an integral part of these financial statements.

## Balance Sheet

At 31 March 2008

	Notes	2008 £'000	Restated 2007 £'000
<b>Fixed assets</b>			
Tangible fixed assets	7	2,903	3,322
Investments: Endowment	8	250,000	250,000
		<b>252,903</b>	<b>253,322</b>
<b>Current assets</b>			
Investments: Endowment	8	50,174	34,905
Investments: Other	8	21,158	23,289
Debtors	9	246	172
Cash at bank and in hand	18	329	431
		<b>71,907</b>	<b>58,797</b>
<b>Less current liabilities</b>			
Creditors: Grants and investments falling due for payment within one year	10	7,633	4,904
Creditors: Other amounts falling due within one year	11	2,607	2,102
		<b>10,240</b>	<b>7,006</b>
		<b>61,667</b>	<b>51,791</b>
<b>Total assets less current liabilities</b>		<b>314,570</b>	<b>305,113</b>
Creditors: Grants and investments falling due for payment after one year	10	6,178	724
<b>Net assets</b>		<b>308,392</b>	<b>304,389</b>
<b>Represented by reserves</b>			
Endowment reserve	2 & 19	308,392	304,389
<b>Total reserves</b>		<b>308,392</b>	<b>304,389</b>

The financial statements, which comprise the income and expenditure account, the statement of total recognised gains and losses, the balance sheet, the cash flow statement and the related notes, were approved by the Board of Trustees on 25 June 2008 and signed on their behalf by:

**Jonathan Kestenbaum** Accounting Officer

**9 July 2008**

The notes on pages 25 to 44 form an integral part of these financial statements.

## Cash Flow Statement

For the year ended 31 March 2008

	Notes	Total 2008 £'000	Restated Total 2007 £'000
<b>Net cash outflow from operating activities</b>			
Payments of grants and investments	10	(7,742)	(8,204)
Payments for staff and trustees' costs		(6,786)	(6,293)
Payments for other costs		(7,688)	(6,564)
Project funding received		65	123
Lottery funding		15,000	15,000
Other income		548	115
	17	<b>(6,603)</b>	<b>(5,823)</b>
<b>Returns on investments</b>			
Interest and dividends received		<b>16,262</b>	<b>15,686</b>
<b>Capital expenditure and financial investment</b>			
Payments to acquire tangible fixed assets		(269)	(3,407)
Receipts from disposal of tangible fixed assets		-	37
Net proceeds from the (purchase)/sale of investments		78,027	(32,338)
Decrease/(increase) in short term deposits		-	35,640
		<b>77,758</b>	<b>(68)</b>
<b>Increase in cash in hand and cash held in investments</b>	18	<b>87,417</b>	<b>9,795</b>

The notes on pages 25 to 44 form an integral part of these financial statements.

# Notes to the Accounts

## For the year ended 31 March 2008

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### 1. Accounting policies

#### Accounting convention

The financial statements 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 financial statements have been prepared in accordance with the Accounts Direction issued by the Secretary of State for Culture, Media and Sport (August 2002) with the consent of Treasury in accordance with Section 23 (2) of the National Lottery Act 1998, and so far as appropriate they meet the requirements of the Companies Act, Managing Public Money and the 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.

Other income comprises royalties received, sale of investments in early-stage companies, project funding and sundry other income.

#### Grants expenditure

Grants 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.

Grant expenditure includes seed and early-stage investments and contributions to investment funds, and 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 when services or goods are received.

#### Investments

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

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

Seed and early-stage investments made under the programmes are not capitalised. Note 8(b) gives details of such investments.

# Notes to the Accounts

## For the year ended 31 March 2008

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### 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. HMRC has recognised this exemption. Accordingly, no taxation has been provided for in these financial statements.

### Value Added Tax

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

### Pensions

The costs of all employer pension contributions are charged to the Income and Expenditure account. Certain employees are members of a defined benefit pension scheme; any known underlying asset or liability is accounted for.

### Operating leases

Rentals payable under operating leases are charged to the Income and Expenditure account on a straight line basis over the term of the lease. Other 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% (2007: 3.5%) of the average non-lottery funded balances employed over the financial year.

## 2. Change in accounting policies and prior period adjustment

In prior years NESTA has applied a spending rule as its accounting policy, wherein the first £10m of a year's expenditure is covered by investment income from that year and the remainder transferred from the Endowment held in current assets. Any investment income received in excess of £10m contributed to any surplus for the year. This policy did not separately disclose additional amounts of lottery funding received in the Income and Expenditure Account, instead a 'transfer from Endowment' being the difference between total expenditure for the year and £10m. In the Balance Sheet, two reserve accounts were held: 'Endowment reserves', and 'accumulated surplus' although no surplus had been gained through operating activity.

From 2007/08, the Income and Expenditure Account will show income as being made up of: investment returns, additional lottery funding and other income. Any surplus or deficit from the year will be added to the Endowment Reserve in the Balance Sheet.

The effect of this change in policy and its prior period effect is as follows:

<b>Income and Expenditure Account</b>	<b>2008 £'000</b>	<b>2007 £'000</b>
Surplus for the year applying prior year policy	10,574	1,456
Change in policy: reverse 'transfer from Endowment'	(21,571)	(10,398)
Add: Lottery funding	15,000	15,000
<b>Restated Surplus for the year</b>	<b>4,003</b>	<b>6,058</b>

<b>Balance Sheet Reserves</b>	<b>2008 £'000</b>	<b>Restated 2007 £'000</b>	<b>Prior Year 2007 £'000</b>
Represented by reserves:			
Endowment Reserve	308,392	304,389	281,134
Accumulated Surplus	-	-	23,255
<b>Total reserves</b>	<b>308,392</b>	<b>304,389</b>	<b>304,389</b>

# Notes to the Accounts

## For the year ended 31 March 2008

### 3. Investment returns

	2008 £'000	2007 £'000
Endowment:		
Gross interest receivable	14,945	14,986
Amortisation of redemption premium	(1,426)	(2,315)
	13,519	12,671
Adjustment to market value	8,250	(4,068)
<b>Total returns on Endowment</b>	<b>21,769</b>	<b>8,603</b>
Other investments:		
Interest and dividends receivable	691	657
Unrealised capital gains/(losses)	(2,594)	2,039
<b>Total returns on other investments</b>	<b>(1,903)</b>	<b>2,696</b>
Bank interest	42	42
	(1,861)	2,738
<b>Total Investment Returns</b>	<b>19,908</b>	<b>11,341</b>

### Endowment

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

DIUS has agreed to a liberalisation of this investment policy, and during 2008/09 NESTA will be investing its Endowment in a broader range of assets with a view to improving returns while limiting volatility through appropriate diversification.

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 2008, cumulative gains due to adjustments to market value include £4,762k (2007: £3,491k accumulated losses) that will reverse in future years.

### Other investments

There were no realised capital gains or losses (2007: £0).

## 4. Other income

	2008 £'000	2007 £'000
Project funding: DfES	-	68
Project funding: DTI	-	10
Project funding: One North East RDA	40	40
Project funding: Highlands & Islands Enterprise Funding	11	15
Royalty income, loan interest and dividends from awards	42	67
Other income	573	48
<b>Total other income</b>	<b>666</b>	<b>248</b>

Project funding is substantially matched against expenditure.

Other income includes amounts received from the provision of services, sale of investments made by the NESTA Investments team (2008: £428k; 2007: £nil), sponsorship and grants, and recharges of expenses.

## 5. Staff costs

	2008 £'000	2007 £'000
Salaries and emoluments of directly recruited staff	5,051	5,038
Salaries and allowances of seconded staff	133	-
Trustees' remuneration	54	47
Social security costs	581	472
Defined contribution pension payments	396	263
Defined benefit pension payments	48	114
Agency/temporary staff costs	159	429
	<b>6,422</b>	<b>6,363</b>
Other staff costs	447	760
<b>Total Staff Costs</b>	<b>6,869</b>	<b>7,123</b>

Further information on pensions is included in Note 16 and in the Remuneration Report.

Other staff costs include recruitment costs of £273k (2007: £431k) and staff training costs.

Interest-free season ticket loans were available to all NESTA staff during the year. As at 31 March 2008, nine staff had taken up these loans. The value in aggregate of season ticket loans in excess of £2,500 is £2,939.

Interest-free bike loans were also available to all NESTA staff during the year. As at 31 March 2008, two staff had taken up these loans. The aggregate of individual season ticket and bike loans are below £5,000.

# Notes to the Accounts

## For the year ended 31 March 2008

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

	Employees 2008	Agency/ contract staff 2008	Staff on secondment 2008	Total 2008	Total 2007
Innovation Programmes	32	-	-	32	33
NESTA Investments	11	-	-	11	11
Policy & Research	11	-	1	12	8
Communication	17	-	-	17	17
Corporate Services/ CEO's Office	22	2	-	24	33
	<b>93</b>	<b>2</b>	<b>1</b>	<b>96</b>	<b>102</b>

## 6. Expenditure

### 6a. Expenditure by activity

Expenditure has been classified by activity: Programmes, Investments, Policy & Research, Communication and Corporate Services.

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

#### Innovation Programmes

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

Total expenditure for the year on continuing activities was £9,235k (2007: £9,171k).

#### NESTA Investments

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

See Note 8(b) for details of active investments held.

Total expenditure for the year on continuing activities was £12,102k (2007: £3,824k).

#### Policy & Research

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

Total expenditure for the year on continuing activities was £3,679k (2007: £1,273k).

## Communications, events and public affairs

Communications, events and public affairs supports and is integrated with Innovation Programmes, NESTA Investments, and Policy & Research. It works across a wide range of activities, including: corporate affairs, media and public affairs, high-level events, branding, publications, websites, competitions, and sponsorships.

Total expenditure for the year on continuing activities was £3,845k (2007: £3,439k).

## 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 £2,710k (2007: £2,824k).

## 6b. Expenditure by type

	2008 £'000	2007 £'000
Investments, grants and projects	19,753	9,758
Staff costs	6,869	7,123
Depreciation	656	452
Loss on disposal of assets	32	79
Legal and audit fees	316	313
Operating leases: land and buildings	851	941
Irrecoverable VAT	988	779
Other operating costs	2,106	1,086
<b>Total continuing and non-exceptional costs</b>	<b>31,571</b>	<b>20,531</b>
<b>Total expenditure</b>	<b>31,571</b>	<b>20,531</b>

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

Staff costs include salaries, National Insurance, pension and benefit contributions and other staff-related costs such as temporary and contract staff, training and development expenditure, end of service and recruitment costs.

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

# Notes to the Accounts

## For the year ended 31 March 2008

### 6c. Further information

Net surplus is stated after charging:	2008 £'000	2007 £'000
Auditor's remuneration: statutory audit services	29	30
Auditor's remuneration: other accounting services	1	1
Staff travel, subsistence and hospitality	366	240
Trustee travel and subsistence	24	16

### 7. Tangible fixed assets

	Leasehold improvement £'000	Computer hardware £'000	Computer software £'000	Office equipment £'000	Fixtures & fittings £'000	Assets under construction £'000	Total £'000
<b>Cost or valuation</b>							
At 1 April 2007	2,397	543	1,089	219	357	42	4,647
Additions	8	153	93	-	17	-	271
Transfers In/(Out)	-	-	9	-	-	(9)	-
Disposals	-	(1)	-	-	-	(33)	(34)
<b>At 31 March 2008</b>	<b>2,405</b>	<b>695</b>	<b>1,191</b>	<b>219</b>	<b>374</b>	<b>-</b>	<b>4,884</b>
<b>Depreciation</b>							
At 1 April 2007	83	129	1,009	80	24	-	1,325
Charge for the year	255	201	74	53	73	-	656
Disposals in year	-	-	-	-	-	-	-
<b>At 31 March 2008</b>	<b>338</b>	<b>330</b>	<b>1,083</b>	<b>133</b>	<b>97</b>	<b>-</b>	<b>1,981</b>
<b>Net Book Value</b>							
<b>At 31 March 2008</b>	<b>2,067</b>	<b>365</b>	<b>108</b>	<b>86</b>	<b>277</b>	<b>-</b>	<b>2,903</b>
At 31 March 2007	2,314	414	80	139	333	42	3,322

Assets have not been revalued at 31 March 2008 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 an historic cost basis.

Assets under construction relate to various information systems and were either disposed of or transferred as assets to other categories during the year. Included in disposals is computer software written off, originally purchased in 2004/05 for £32,480 which has not been implemented and is not practical to upgrade.

## 8a. Investments

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

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

During 2008/09 NESTA will be investing its Endowment in a broader range of assets with a view to improving returns while limiting volatility through appropriate diversification.

	Cost 2008 £'000	Market value 2008 £'000	Cost 2007 £'000	Market value 2007 £'000
Cash and short-term deposits	97,313	97,623	9,814	9,848
Government Stocks – Up to one year	48,939	50,737	110,543	104,052
Government Stocks – Two to five years	147,107	151,814	148,103	147,329
Government Stocks – Over five years	-	-	23,786	23,676
<b>Total Endowment</b>	<b>293,359</b>	<b>300,174</b>	<b>292,246</b>	<b>284,905</b>
Cash and short-term deposits	453	453	433	433
UK equities	14,010	14,871	13,441	16,023
Property funds	4,650	5,834	4,648	6,833
<b>Total other investments</b>	<b>19,113</b>	<b>21,158</b>	<b>18,522</b>	<b>23,289</b>
<b>Total investments</b>	<b>312,472</b>	<b>321,332</b>	<b>310,768</b>	<b>308,194</b>
<b>Represented in the Balance Sheet as:</b>		<b>Market value 2008 £'000</b>		<b>Market value 2007 £'000</b>
Fixed Assets – Investments, Endowment		250,000		250,000
Current Assets – Investments, Endowment		50,174		34,905
Current Assets – Investments, Other		21,158		23,289
		<b>321,332</b>		<b>308,194</b>

## Notes to the Accounts

### For the year ended 31 March 2008

<b>At market value:</b>	<b>Endowment 2008 £'000</b>	<b>Other 2008 £'000</b>	<b>Total 2008 £'000</b>	<b>Endowment 2007 £'000</b>	<b>Other 2007 £'000</b>	<b>Total 2007 £'000</b>
1 April 2007	284,905	23,289	<b>308,194</b>	284,802	20,766	<b>305,568</b>
Lottery funding	15,000	-	<b>15,000</b>	15,000	-	<b>15,000</b>
Investment returns/(losses)	21,769	(1,903)	<b>19,866</b>	8,603	2,696	<b>11,299</b>
Transfer to cover expenditure	(21,500)	(228)	<b>(21,728)</b>	(23,500)	(173)	<b>(23,673)</b>
<b>31 March 2008</b>	<b>300,174</b>	<b>21,158</b>	<b>321,332</b>	<b>284,905</b>	<b>23,289</b>	<b>308,194</b>

## 8b. Seed and Early-Stage Investments

NESTA Investments has made equity, participating or convertible loan or quasi-equity investments in a portfolio of early-stage, start-up companies, and made contributions to early-stage investment funds. A summary of the portfolio of investments held at 31 March 2008 is set out below.

<b>Company</b>	<b>Cash investment to 31 March 2008 £'000</b>	<b>Company</b>	<b>Cash investment to 31 March 2008 £'000</b>	<b>Company</b>	<b>Cash investment to 31 March 2008 £'000</b>
Cellcentric Ltd	500	Camrivox Ltd	240	Cytox Ltd	150
Tideway Systems Ltd	500	Hypertag Ltd	238	Micrima Ltd	150
Light Blue Optics Ltd	441	Haemostatix Ltd	225	Plasma Clean Ltd	150
Veryan Medical Ltd	431	NanoSight Ltd	225	ProVision Communication Technologies Ltd	150
Quotient Diagnostics Ltd	416	St Andrews Fuel Cells Ltd	219	Spiral Gateway Ltd	145
Ashe Morris Ltd	375	Probe Scientific Ltd	211	Dialog Devices Ltd	125
Symetrica Ltd	374	Meciria Ltd	204	Thermal Energy Systems Ltd	125
MMIC Solutions Ltd	360	Scyron Ltd	200	Odontis Ltd	110
AquaPharm Bio-Discovery Ltd	325	Cardiak Ltd	196	ROBAT Ltd	105
Starbridge Systems Ltd	263	Orthogem Ltd	151	ProKyma Technologies Ltd	100
Advanced Transport Systems Ltd	250	CamFPD Ltd	150	Bluegnome Ltd	100
Surface Generation Ltd	250	Ceravision Ltd	150		
					<b>8,304</b>
				<b>Other investments of less than £100k</b>	<b>735</b>
				<b>Less investments sold</b>	<b>(150)</b>
				<b>Total investment at cost</b>	<b>8,889</b>
				<b>Number of investments in companies</b>	<b>47</b>

Using valuation guidelines produced by the British Venture Capital Association (BVCA) and in line with best practice, NESTA estimates the value of this portfolio to be £8.9m as at 31 March 2008. Whereas 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 NESTA Investments includes in its estimated value an uplift in valuation only if there is significant investment from an institutional 3rd party investor in a subsequent round.

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.

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

<b>Funds</b>	<b>Cash investment to 31 March 2008 £'000</b>
Pentech Fund II	78
IP Venture Fund	182
Seedcamp	68
<b>Total investment at cost</b>	<b>328</b>
<b>Number of investments in funds</b>	<b>3</b>

During the year 21 investments were made into new and existing portfolio companies at a total cost of £2.3m and three contributions to investment funds at a total cost of £328k.

	<b>Number</b>	<b>Cost £'000</b>
<b>Portfolio at 1 April 2007</b>	<b>41</b>	<b>6,727</b>
New investments – companies	7	725
Further investments to existing portfolio – companies	14	1,587
Less investments sold – companies	(1)	(150)
New investments – funds	3	328
<b>Portfolio at 31 March 2008</b>	<b>50</b>	<b>9,217</b>

# Notes to the Accounts

## For the year ended 31 March 2008

### 9. Debtors

	2008 £'000	2007 £'000
Trade debtors	159	107
Prepayments	95	63
Accrued income	-	11
Less provision for doubtful debts	(8)	(9)
<b>Total debtors</b>	<b>246</b>	<b>172</b>

NESTA is required to disclose the value of any debtor balances with other bodies within the Whole of Government Accounts (WGA) boundary. There were year-end balances held with the following organisations, inclusive of VAT:

	2008 £'000
Balances with government bodies	63
Balances with NHS bodies	50
	<b>113</b>
Balances with bodies external to government	46
<b>Total debtors</b>	<b>159</b>

### 10. Creditors: Grants and Investments

Contracted commitments	At 31 March 2007 £'000	New commitments £'000	Commitments paid £'000	De-commitments £'000	At 31 March 2008 £'000
Innovation Programmes	5,048	4,390	(4,355)	(291)	4,792
NESTA Investments	449	10,156	(2,680)	(134)	7,791
Policy & Research	131	1,814	(707)	(10)	1,228
<b>Total</b>	<b>5,628</b>	<b>16,360</b>	<b>(7,742)</b>	<b>(435)</b>	<b>13,811</b>

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

	Within 1 year £'000	1 to 2 years £'000	2 to 3 years £'000	3 to 4 years £'000	4 to 5 years £'000	Total £'000
Innovation Programmes	4,094	506	192	-	-	4,792
NESTA Investments	2,311	1,258	1,166	1,188	1,868	7,791
Policy & Research	1,228	-	-	-	-	1,228
<b>Total</b>	<b>7,633</b>	<b>1,764</b>	<b>1,358</b>	<b>1,188</b>	<b>1,868</b>	<b>13,811</b>

Payments under contracted commitments are disclosed in the balance sheet as: due for payment within one year: £7,633k; due for payment after one year: £6,178k.

Awards committed or approved but not yet contracted are set out in Note 13.

## 11. Creditors: other amounts falling due within one year

	2008 £'000	2007 £'000
Trade creditors	659	227
Taxation and social security	177	152
Other creditors	24	3
Accruals and deferred income	1,747	1,720
<b>Total creditors</b>	<b>2,607</b>	<b>2,102</b>

NESTA is required to disclose the value of any year-end creditor balances with other bodies within the Whole of Government Accounts (WGA) boundary. There were year-end balances held with the following organisations, inclusive of VAT:

	2008 £'000
Balances with government bodies	57
Balances with Scottish local government bodies	30
Balances with English local government bodies	21
Balances with National Health Service bodies	125
	<b>233</b>
Balances with bodies external to government	426
<b>Total trade creditors</b>	<b>659</b>

## Notes to the Accounts

### For the year ended 31 March 2008

#### 12. Provisions and contingent liabilities

The lease agreement for the rental property at 1 Plough Place expires in 2021. Due to uncertainty in timing and amount, no estimate for a contingent liability for dilapidations has been made.

#### 13. 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 2007 £'000	Approvals £'000	Contracted £'000	Cancelled / Withdrawn £'000	At 31 March 2008 £'000
Innovation Programmes	409	6,254	(4,390)	(211)	2,062
NESTA Investments	3,475	8,227	(10,156)	(307)	1,239
Policy & Research	598	1,352	(1,814)	(45)	91
<b>Total</b>	<b>4,482</b>	<b>15,833</b>	<b>(16,360)</b>	<b>(563)</b>	<b>3,392</b>

Cancelled/withdrawn soft commitments are lower than in the previous two years (2007: £1,417; 2006: £1,306). Many soft commitments do not reach the point of formal, contracted hard commitment. Common reasons include: the breaking down of contract negotiations where NESTA and the organisation do not agree final terms, the organisation accepting an offer from an alternative funding body, or the organisation not raising additional funds required to complete larger rounds of financing.

#### 14. Capital commitments

Approved and contracted:	2008 £'000	2007 £'000
Audio-visual specifications	58	-
<b>Total</b>	<b>58</b>	<b>-</b>

The amount payable within one year is £58k.

## 15. Operating lease commitments

At 31 March 2008, NESTA had an annual commitment under operating leases as follows:

	Less than 1 year to expiry	1-5 years to expiry	More than 5 years to expiry	2008 £'000	2007 £'000
<b>Land and Buildings:</b>					
1 Plough Place, London			13 yrs 3 mths	709	709
Scotswood Road, Newcastle Upon Tyne	3 mths			7	5
West Bute Street, Cardiff		1 yr 4 mths		6	6
Scion House, Stirling	6 mths			10	10
<b>Other Leases:</b>					
Photocopiers		3 yrs		19	19
<b>Total</b>				<b>751</b>	<b>749</b>

In addition to the premises mentioned above, NESTA maintains a regional office in Dundee, on a short term lease.

## 16. 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 £444k, including outstanding contributions of £23k.

### PSATSITA Scheme

NESTA and certain of its employees contribute to a multi-employer, trustee-administered fund independently managed and invested by a leading fund management company. The scheme is a defined benefit scheme. As NESTA is unable to identify its share of the underlying assets and liabilities, the scheme has 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 2007 was £10,200k, representing 100% 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% (from 1 April 2008: 19.4%) and 5.5% of pensionable earnings respectively.

The total annual pension is calculated as 1/60ths 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 3/80ths of the final pensionable earnings for each year of service may be taken as a lump sum.

## Notes to the Accounts

### For the year ended 31 March 2008

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

	2008 £'000	Restated 2007 £'000
Surplus for the year	4,003	6,058
Investment returns – interest and dividends	(19,908)	(11,341)
Depreciation	656	452
Loss on disposal of assets	32	79
(Increase)/Decrease in debtors	(74)	459
Increase/(Decrease) in grants and investments contracted	8,183	(1,278)
Increase/(Decrease) in other creditors	505	( 7)
Increase/(Decrease) in provisions and charges	-	(245)
<b>Net cash outflow from operating activities</b>	<b>(6,603)</b>	<b>(5,823)</b>

#### 18a. Analysis of net cash in hand and cash held in investments

	2008 £'000	2007 £'000	Movement £'000
At bank and in hand	92	294	(202)
Held in escrow	237	137	100
Included in bank and in hand	329	431	(102)
Included in investments – fixed and current assets	97,766	10,247	87,519
<b>Total</b>	<b>98,095</b>	<b>10,678</b>	<b>87,417</b>

The cash movement largely represents the portion of Endowment investments held in gilts which matured during the 2007/08 year, and is held in readiness for reinvestment following the liberalisation of the Endowment investment policy.

## 18b. Reconciliation of net cashflow to movement in net funds

	2008 £'000	2007 £'000
Decrease in cash on hand	(102)	(442)
Cash inflow from increase in liquid resources	87,519	10,237
Movement in net funds	87,417	9,795
Net funds 1 April 2007	10,678	883
<b>Net funds 31 March 2008</b>	<b>98,095</b>	<b>10,678</b>

## 19. Reserves

	Restated Endowment reserve £'000
At 1 April 2007	304,389
Surplus for the year	4,003
<b>At 31 March 2008</b>	<b>308,392</b>

Up to £58,392k (2007; £54,389k) of the Endowment reserve can be used to cover commitments made up to 31 March 2008.

## 20. 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. The key relevant risks are set out below. Short term debtors and creditors have minimal financial risk and are not separately disclosed.

### Liquidity risks

In 2008, £19,908k (56%) of NESTA's income derived from the returns accruing on its investments. The remaining income is Lottery funding of £15,000k (42%) and project funding and other income of £666k (2%).

NESTA is satisfied that it has sufficient certainty over future income and liquid resources in the form of cash of £329k and current asset investments of £71,332k and is therefore not exposed to significant liquidity risks.

# Notes to the Accounts

## For the year ended 31 March 2008

### Interest rate risks

For the main part of its Endowment investment to 31 March 2008, NESTA had 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. From 2008/09 the Government has agreed to a liberalisation of this policy of investing in gilts, which will enable NESTA to reduce the risk of medium to long-term exposure to persistent changes in interest rates by investing its Endowment in a broader range of assets with a view to limiting volatility through appropriate diversification. To effect this diversification, any maturing investments during the year remained as cash and were held in government interest-bearing call accounts.

### Interest rate profile

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

	Market value £'000	Weighted average interest rate %	Weighted average period for which rate is fixed
<b>At 31 March 2008</b>			
Fixed rate	202,861	5.29%	2 years, 6 months
Floating rate	98,095	4.98%	
Non-interest bearing assets	20,705		
	<b>321,661</b>		
<b>At 31 March 2007</b>			
Fixed rate	272,610	5.38%	2 years, 4 months
Floating rate	10,678	5.23%	
Non-interest bearing assets	25,337		
	<b>308,625</b>		

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

The assets above are included in the Balance Sheet as:	2008 £'000	2007 £'000
Fixed asset investments	250,000	250,000
Current asset investments	71,332	58,194
Cash at bank and in hand	329	431
<b>Total</b>	<b>321,661</b>	<b>308,625</b>

## Inflation rate risks

NESTA is exposed to cost inflation, particularly in relation to staff costs. At the same time, the majority of its Endowment is invested in fixed income gilts that do not provide any form of cover against changes in inflation. Whilst this is not considered a substantial risk to effective operations in the short term, assuming no substantial and unexpected increase in inflation, it does pose challenges to NESTA in the medium to longer term. DIUS has now agreed to a liberalisation of this regime, and during 2008/09 NESTA will be investing its Endowment in a broader range of assets with a view to improving returns while limiting volatility through appropriate diversification.

## Foreign Exchange and Credit Risks

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

## 22. Related parties

NESTA is an NDPB of the Department for Innovation, Universities and Skills (DIUS). NESTA had no material financial transactions with DIUS during the year.

NESTA has had material transactions with other Government Departments and other central Government bodies, namely: the Department for Culture, Media and Sport which is parent department for the Big Lottery Fund (BLF), the Department for Business Enterprise & Regulatory Reform, and the Commissioners for the Reduction of the National Debt.

## Notes to the Accounts

### For the year ended 31 March 2008

The following related party transactions occurred during the period:

Organisation	Relationship with with recipient organisation	Transaction type	Transactions for the year £'000	Balance outstanding £'000
<b>Trustees of NESTA</b>				
Library House	Director	Procurement of services	44	-
<b>Committee Members of NESTA</b>				
MTI Partners	CEO and Managing Director of the fund manager of a NESTA investment	NESTA Investments, investment in early-stage fund	-	3,500
<b>Employees of NESTA</b>				
British Business Angel Association	Director	Sponsorship	5	-
Royal Society for the encouragement of Arts, Manufactures and Commerce	Advisory Committee member	Sponsorship, Grants (Innovation Programmes)	189	40
Young Foundation	Spouse of Director	Grants (Innovation Programmes and Research)	527	754

NESTA is satisfied that the above mentioned transactions were entered into in the ordinary course of business, and on arms' length terms.









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