

Annual Accounts and
Financial Statements ²⁰**06**

For the year ended 31 July



HERIOT-WATT UNIVERSITY

REPORT AND FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 JULY 2006

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OPERATING AND FINANCIAL REVIEW

SCOPE OF THE FINANCIAL STATEMENTS

The financial statements which have been approved by the Court for the year-ended 31 July 2006 consolidate the transactions of the University and its subsidiary undertakings.

RESULTS FOR THE YEAR

The consolidated income and expenditure was:

	2006	2005	2004
	£m	£m	£m
Income	99.5	94.6	90.9
Expenditure	(98.4)	(93.0)	(89.6)
Net surplus for the year	<u>1.1</u>	<u>1.6</u>	<u>1.3</u>

The group's surplus for 2005-06 fell by 29% compared to the prior year, though that year's results were ahead of budget. Revenues increased by 5.2% during the year but this was more than offset by increases in both staff costs and other operating costs of 5.6% and 7.0% respectively. Finance costs decreased during the year by almost 10% as the benefit of the continued focus on cash management resulted in a reduction in interest charges.

Grants received from the Scottish Funding Council (SFC) increased by 3.2% for teaching and 6.6% for research. Tuition fees from UK and EU HE students fell by 2.4% but, tuition fees from non-EU students were successfully grown by 9.1%. Income received from Research Grants and Contracts and other sources only increased by 0.4%. However, Heriot Watt continues to play a major role in the research pooling initiatives recently announced by SFC. Over £7.3 million has been awarded to Heriot-Watt University in support of research collaborations with other Scottish Universities over the next four years, further enhancing the University's research status.

CASH FLOW MANAGEMENT

The group has continued to focus on cash flow to ensure both that debt levels are controlled and that cash continues to be made available as necessary for educational activities.

This continued focus had a positive effect with consolidated net debt at the end of the financial year being reduced by 9% to £16.2 million (2005 - £17.8 million). Cash outflows were reduced primarily due to lower net capital expenditure and lower net service costs of financing. A project is underway to identify opportunities to further improve cash management.

The University's net debt at the year-end, excluding the Edinburgh Business School, was £22.4 million (2005 - £26.8 million).

Unless special terms are agreed, it is group policy to pay invoices at the end of the month following the month in which the invoice is dated. At 31 July 2006 there were 24 days (2005 - 21 days) of purchases in trade creditors. No interest was payable under the terms of the Late Payment of Commercial Debts (Interest) Act 1998.

CAPITAL PROJECTS

During the year £5.4 million (2005 - £5.7 million) was invested in additions to the fabric and infrastructure of the capital base.

Significant capital spend was incurred to enhance existing research capabilities, funded by grants from the SRIF (Scientific Research Investment Fund) scheme.

Confirmation has been received of the Funding Council's intent to invest through the Learning & Teaching Infrastructure Fund (LTIF) and this capital will be combined with the group's own funds to continue improvements to the Learning & Teaching infrastructure.

A fundraising programme has been established with the objective of raising £5 million in funds to support learning and teaching initiatives, including a new Postgraduate Centre and an enhanced programme of student scholarships.

ACTIVITIES DURING THE FINANCIAL YEAR

The University's student numbers, expressed as full-time equivalents, for the current and the previous year are:

<u>On Campus (Scotland)</u>		2005-06	2004-05
Home/EU	Undergraduate	4,699	4,755
	Postgraduate	729	780
International	Undergraduate	405	397
	Postgraduate	695	658
Total		<u>6,528</u>	<u>6,590</u>

<u>External Programmes, Distance Learning & Dubai campus</u>		2005-06	2004-05
	Undergraduate	1,330	980
	Postgraduate	1,350	1,350
Total		<u>2,680</u>	<u>2,330</u>

DUBAI CAMPUS

The University successfully opened its Dubai campus in 2005-06 and in its first year offered MSc IT, Strategic Project Planning and BA Management courses.

The campus has continued to expand and for 2006-07 academic year student registrations increased to 270 students, a 63% increase on the prior year. The range of courses on offer has also been extended to include Construction Management, Engineering and the MBA.

FUTURE PLANS

The mission of Heriot-Watt University is to create and transfer knowledge, to enable students and staff to fulfil their potential and to enrich the communities with which it engages.

The University is continuing to implement its strategy to develop learning and teaching delivery, focusing on internationally recognised research, collaboration in research projects and the recruitment of high quality postgraduate students.

FINANCIAL PLANNING

The group's financial planning is designed to enhance revenues and minimise avoidable costs in order to generate net surpluses for investment in the furtherance of its educational objectives.

The latest three year plan, filed with the Scottish Funding Council (SFC) at the beginning of July 2006, projected operating surpluses in each year of the plan of less than 1% of turnover. This flat performance was the consequence of several key factors, of which the more significant were the impact of settling the new Framework Agreement on staff pay and continued upward pressure on costs, particularly utility costs.

The University's management group (the Planning and Management Executive) has proposed a fundamental review of the existing strategy implementation framework with the intention of better aligning resources with agreed strategic objectives.

All Higher Education Institutions have been encouraged to aspire to achieving 'financial sustainability' which is defined by the SFC as 'the need to plan and manage key resources to at least maintain the capacity of the institution to respond appropriately to future demands'. Heriot-Watt is committed to generate funds to invest in maintaining and developing the quality of its educational provision, its research and the infrastructure in which these are provided.

Consequently, the Court of Heriot-Watt has agreed that one output of the above strategy review should be the production of a five year plan that will aim to deliver a significantly enhanced operating surplus to help secure delivery of its mission. This will be an ambitious target relative to the current performance but its achievement is essential if the university is to generate sufficient cash from operations to become sustainable on a full economic costing basis.

EMPLOYEES

The new National Framework Agreement will introduce new terms and conditions for the group's employees and introduce procedures to encourage staff development and performance management. Heriot-Watt will obtain full agreement with its employee representative groups by February 2007.

The improvement and modernisation of terms and conditions is a welcome benefit but it has resulted in a significant increase in the structural cost of the group. Implementing the agreement will add 5% to the payroll cost in 2006-07.

Staff are kept up-to-date with strategy implementation and financial and academic performance through a variety of communication channels.

STUDENTS

Students are represented on several Court Committees and on other management groups set up by the University's Planning and Management Executive, where their input is sought on matters affecting development of the University strategy. The University has had a long and successful track record of involving its students in influencing the University's key areas of performance.

DONATION

No donations in excess of £200 were made during 2005-06 to UK political and charitable organisations.

INSURANCE

The group has insurance policies in place for its officers and for potential claims against them in connection with their role in managing the organisation.

PENSIONS

The group's employees are members of one of four pension schemes, details of which are set out in note 31, which starts on page 33. All of these schemes provide benefits to members based on final pensionable pay.

The group has fully implemented FRS 17 'Retirement Benefits' during the year and this has resulted in a material impact on the financial statements for both the year being reported and, via a prior year adjustment, the comparatives for the previous year. Details of these adjustments are set out in note 25.

Employer contributions payable for the year totalled £6 million (2005: £5.6 million), of which contributions due to the Universities Superannuation Scheme (USS) and the Scottish Teachers Superannuation Scheme (STSS) increased by 5% per annum or less, but contributions to the Lothian Pension Fund (LPF) increased by 11% after a 1% increase in the employer contribution rate during the year.

In common with other pension funds both USS and LPF are subject to triennial valuations of their scheme's assets and liabilities by professional actuaries and new valuation reports, as at 31st March 2005, were published for both schemes during the year.

The March 2005 valuation of USS stated that the scheme was 126% funded using the Minimum Funding Requirement (MFR) assumptions introduced by the Pensions Act 2005 and 100% funded in terms of the Pension Protection Fund (PPF) regulations introduced by the Pensions Act 2004. However, using more conservative internally determined assumptions, it was determined that the assets of the scheme were 77% of the accrued liabilities based on projected pensionable salaries with a past service deficit of £6,568 million. No increase in the employer contribution rate was proposed and the Chief Executive's conclusion was that "The management committee considers that the funding objective, the valuation method and the assumptions underlying the valuation calculations together represent a satisfactory basis for the long-term funding of the benefits provided by USS".

The March 2005 valuation of LPF stated that, using internally determined assumptions, the scheme was 85% funded when comparing the ratio of assets to past service liabilities with a past service deficit of £358 million. For the scheme neither MFR nor PPF valuations are required and no such valuations were provided.

Following on from LPF's 2005 actuarial valuation an increase in the group's employer contribution rate, based on a valuation of its identifiable share of the scheme, of 3% was proposed. This increase is being phased in over three years, with the first increase of 1% having taken place in April 2006. Consequently, further increases in contributions payable of 10% plus are expected to occur in both 2006-07 and 2007-08.

The group's management have commissioned professional advice to assess the options available to resolving this situation.

MINORITY INVESTMENTS

The group has had, for a number of years, a policy for the commercialisation of its research base, in some cases through the creation of 'spin-out' companies, in which it retains a minority investment. As at 31 July 2006 there were fifteen investments (2005 – twelve) in a range of different companies. The market value of these investments is not reflected in the group's financial statements.

EMPLOYMENT OF DISABLED PERSONS

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of existing employees becoming disabled every effort is made to ensure that their employment with the group continues and that appropriate training is arranged. It is the policy of the group that the recruitment, training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

Prof. John Simmons

Acting Principal & Chief Accounting Officer

Gavin J N Gemmell

Chairman of Court

CORPORATE GOVERNANCE STATEMENT

INTRODUCTION

The University is committed to exhibiting best practice in all aspects of corporate governance and this statement describes the principal governance provisions which presently apply. The Court of the University keeps these provisions under review to take account of best practice from time to time including the principles set out in the Guide for Members of Higher Education Governing Bodies in the UK prepared by the Committee of University Chairmen (CUC). This incorporates internal control guidance for directors on the Combined Code as amended by the British Universities Finance Directors Group.

In the opinion of the Court, the University complied with the Governance Code of Practice and General Principles and the provisions of the Code provided by the CUC throughout the year ended 31 July 2006. The Court also regularly reviews its governance provisions in line with both recommendations made by SFC and any changes made in the CUC Code.

GOVERNING BODY

The Court, which has twenty six members including the Chairman, who is always one of the lay members, is the ultimate decision taking body. Fourteen of the Court members are directly elected, five are co-opted and the others are ex officio. As this is more than the recommended number of members laid down in the SFC guidelines, the Court has decided to move towards reducing the membership of Court to twenty five members as existing members of Court come to the end of their existing term of office. The Court has responsibility for the University's strategic direction, reputation, financial well-being, the well-being of staff and students and, in association with the Senate, establishing and maintaining high standards of academic conduct and probity.

To discharge these responsibilities:

- The Court met five times during the year. The principal business of the Court is the consideration and approval of strategic plans and annual budgets, the monitoring of staffing, student, estates and finance issues, the setting and review of appropriate performance measures and ensuring that there is a clear definition of delegated powers and lines of accountability. At each meeting the Court receives a management report from the Principal as well as reports from its Committees. The University's senior management attend Court meetings along with Deans and Deputy Principals to ensure optimum communication within the University.
- The terms of reference of all of the Court Committees are agreed by the Court
- The Court has a Remuneration Committee made up of lay members. The Principal and Secretary are in attendance if required but are not present when their personal remuneration is considered. There is also a Nominating & Review Committee of Court made up of lay members, Principal and Vice-Principal, with the lay members being in the majority. The Remuneration and Nominating Committees meet at least once per year under the convenorship of the Chairman of Court.
- The Court has an Audit Committee made up of lay members which meets at least three times a year with the External and Internal Auditors. It receives and considers reports and recommendations for the improvement of internal controls along with management responses. It also reviews the University's annual financial statements.
- The Court also has Finance, Estate Strategy and Staffing Strategy Committees each of which has a different lay member of Court as convenor.
- There is an Emergency Committee consisting of the Chairman of Court, the convenor of the Finance, the Principal and Vice Principal ex officio, and two of the University's elected members of staff on Court. The Committee deals with emergency business which may arise between Court meetings.
- Where the University has commercial interests, the Court, through the University's management, appoints directors to the boards of companies appropriate to the nature and size of the University's shareholding.
- The University has taken necessary steps to ensure compliance with FR58 on Related Party transactions and any interests which require to be disclosed to members of Court are recorded in the Court minutes. The Register of Interest for members of Court is maintained and updated annually.
- The Secretary of the University is the Clerk to the Court.

CORPORATE STRATEGY

The University's strategy is documented in its 3 year plan which is reviewed and updated on an annual basis. A copy of the plan is presented annually to the Funding Council.

STATEMENT OF RESPONSIBILITIES OF THE UNIVERSITY COURT

The Court is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the University, and enable it to ensure that the financial statements are prepared in accordance with the University's Charter, the Statement of Recommended Practice (SORP): Accounting for Further and Higher Education, Accounts Directions from SFC and other relevant accounting standards. In addition, within the terms and conditions of a Financial Memorandum agreed between the Scottish Funding Council and the Court of the University, the Court, through its designated office holder, is required to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the University and of the surplus or deficit and cash flows for that year.

The University acknowledges that the Court has assumed new responsibilities as from April 2006, being the date when the Office of the Scottish Charity Regulator (OSCR) assumed its new statutory responsibilities and powers as a statutory non Ministerial Department. The University believes that the delivery of its mission by its charitable activities provides ongoing public benefit. It aims to comply with OSCR's regulatory requirements as they are developed, including the requirement to maintain independent control by its trustees.

In causing the Accounts to be prepared the Court has ensured that:

- they are prepared on the going concern basis in that the Court is satisfied that the University has adequate resources to continue in operation for the foreseeable future.
- suitable accounting policies are selected and applied consistently.
- judgements and estimates are made that are reasonable and prudent.
- applicable accounting standards are followed, subject to any material departures disclosed and explained in the Accounts.

The Court has taken reasonable steps to:

- ensure that funds from SFC are used only for the purposes for which they have been given and in accordance with the Financial Memorandum and any other conditions which the Funding Council may from time to time prescribe. Under the terms of the Financial Memorandum the designated officer, who is required to ensure such compliance, is the Principal and Vice-Chancellor.
- ensure that there are appropriate financial and other internal controls in place to safeguard public funds and funds from other sources. This system of internal control is continuously reviewed and developed in line with current best practice.
- safeguard the assets of the University and prevent and detect fraud.
- secure the economical, efficient and effective management of the University's resources and expenditure.
- ensure that the University management has an adequate system of internal control, and regularly monitors and reviews its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

RISK MANAGEMENT AND INTERNAL CONTROLS

The University's system of internal financial control includes the following:

- definition of the responsibilities of, and the authority delegated to, heads of academic and administrative operating groups.
- a comprehensive planning process for each operating group, together with detailed annual income, expenditure, capital and cash flow budgets, overseen by the Deputy Principal (Resources) together with the Director of Finance and the Director of Planning.
- Monthly reviews of financial results involving variance reporting and updates of forecast outturns and regular reviews of academic performance
- Clearly defined requirements for approval of expenditure, with investment decisions involving capital or revenue expenditure being subject to formal detailed appraisal and review according to approval levels set by the Court.
- Comprehensive Financial Regulations, detailing financial controls and procedures, approved by the Audit Committee and Court. These Regulations are currently under review and an updated set will be presented to the Audit Committee at Court for approval in early 2007.
- An Internal Audit team whose annual programme is approved by the Audit Committee and who report to the Audit Committee. All recommendations from internal audit reports are implemented to agreed time plans. A new firm, Scott Moncrieff, Chartered Accountants, was appointed on 1st August 2006 as Internal Auditors.
- During the year management identified several areas with potentially significant weaknesses and prioritised the available internal audit resource to investigate them. Two of these, accounts receivable and the Dubai campus confirmed that controls required significant improvement and the reports identified a number of ways in which controls may be strengthened. These recommendations will all be implemented during 2007.
- Recommendations from the external auditors are also implemented to agreed time plans with priority allocated in accordance with the ranking set out in the audit reports.
- An ongoing process for identifying, evaluating and managing the University's significant risks has been in place throughout the period. This process is regularly reviewed by the Audit Committee.

The Audit Committee on behalf of Court, with the assistance of both external and internal audit, considers the wider aspects of internal control within the University. The Audit Committee, with the assistance of internal audit, also considers the issue of value for money within the University. At the Court meeting on 11th December 2006, the Audit Committee convenor expressed satisfaction at the University's approach to improving internal controls.

GOING CONCERN

The Court is satisfied that the University continues to operate as a going concern.

CONCLUSION

The University has made good progress in developing its compliance with best practice in Corporate Governance and is improving its system of internal controls.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE UNIVERSITY COURT OF HERIOT-WATT

We have audited the group and parent University financial statements of Heriot-Watt University for the year ended 31 July 2006 which comprise the group Income and Expenditure Account, the group and parent University Balance Sheets, the group Cash Flow Statement, the group Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the University Court, in accordance with the Charter and Statutes of the University. Our audit work has been undertaken so that we might state to the University Court those matters we are required to state to it in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the University Court, for our work, for this report, or the opinion we have formed.

RESPECTIVE RESPONSIBILITIES OF THE UNIVERSITY COURT AND AUDITORS

The University Court's responsibilities for preparing the Operating and Financial Review and the group and parent University financial statements in accordance with the Statement of Recommended Practice: Accounting for Further and Higher Education, applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Statement of Recommended Practice: Accounting for Further and Higher Education. We also report to you whether income from funding bodies, grants and income for specific purposes and from other restricted funds administered by the University have been properly applied only for the purposes for which they were received and whether, in all material respects, income has been applied in accordance with the Statutes and, where appropriate, with the Financial Memorandum with the Scottish Funding Council. We also report to you whether in our opinion the Operating and Financial Review is not consistent with the financial statements, if the University has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

We read the Operating and Financial Review and the Corporate Governance Statement and consider the implications for our report if we become aware of any apparent misstatements within them or material inconsistencies with the financial statements.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code of Audit Practice issued by the Scottish Higher Education Funding Council. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the University Court in the preparation of the financial statements and of whether the accounting policies are appropriate to the group and parent University's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

OPINION

In our opinion:

- the financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of affairs of the group and parent University as at 31 July 2006 and of the group's surplus of income over expenditure for the year then ended;
- the financial statements have been properly prepared in accordance with the Statement of Recommended Practice: Accounting for Further and Higher Education;
- in all material respects, income from the Scottish Funding Council, grants and income for specific purposes and from other restricted funds administered by the University during the year ended 31 July 2006 have been applied for the purposes for which they were received; and
- in all material respects, income during the year ended 31 July 2006 has been applied in accordance with the University's statutes and, where appropriate, with the Financial Memorandum with the Scottish Funding Council.

KPMG LLP

KPMG LLP
Chartered Accountants
Registered Auditor
Saltire Court
20 Castle Terrace
Edinburgh
EH1 2EG

15 DECEMBER 2006

CONSOLIDATED INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDED 31 JULY 2006

	Note	2006 £000	Re-stated 2005 £000
Income			
Funding Council Grants	2	35,554	33,926
Tuition Fees and Education Contracts	3	28,476	24,074
Research Grants and Contracts	4	15,123	15,059
Other Income	5	19,417	20,789
Endowment and Investment Income	6	975	788
Total income		<u>99,545</u>	<u>94,636</u>
Expenditure			
Staff Costs	7	56,798	53,802
Other Operating Expenses	8	35,638	33,301
Depreciation	11	4,269	4,118
Interest Payable	9	1,596	1,770
Total expenditure	10	<u>98,301</u>	<u>92,991</u>
Surplus on continuing operations after depreciation of tangible assets and before taxation		1,244	1,645
Gain on disposal of assets		5	37
Surplus on continuing operations after depreciation and disposal of assets but before taxation		<u>1,249</u>	<u>1,682</u>
Taxation		-	-
Surplus on continuing operations after depreciation and disposal of assets and taxation		<u>1,249</u>	<u>1,682</u>
Transfer from accumulated income to specific endowments and restricted funds		(138)	(118)
Net surplus for the year retained within general reserves	24	<u>1,111</u>	<u>1,564</u>

All transactions are in respect of continuing operations.

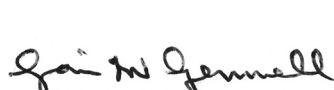
CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDING 31 JULY 2006

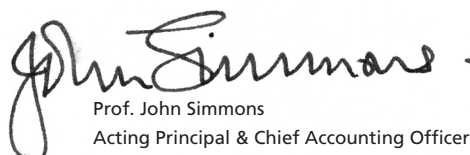
		2006	Re-stated 2005
	Note	£000	£000
Surplus on Continuing Operations after Depreciation of Assets at Valuation		1,111	1,564
Appreciation of endowment asset investments	15	381	710
New endowments	15	207	178
Actuarial gain/(loss) in respect of pension scheme		1,818	(2,034)
Total recognised gains relating to the year		3,517	418
Prior year adjustment	25	(13,263)	-
Total recognised (losses)/gains since last financial statements		<u>(9,746)</u>	<u>418</u>
Reconciliation			
Opening reserves and endowments as re-stated		17,809	17,391
Total recognised gains relating to the year		3,517	418
Closing general reserve and endowments		<u>21,326</u>	<u>17,809</u>

BALANCE SHEETS AS AT 31 JULY 2006

	Note	Group		University	
		2006 £000	Re-stated 2005 £000	2006 £000	Re-stated 2005 £000
Fixed Assets					
Tangible Assets	11	97,974	96,880	86,768	85,543
Intangible Assets	12	216	-	-	-
Investments	13	2,315	394	7,186	186
Total fixed assets		<u>100,505</u>	<u>97,274</u>	<u>93,954</u>	<u>85,729</u>
Endowment Assets	15	<u>6,926</u>	<u>6,338</u>	<u>5,261</u>	<u>4,855</u>
Stock		21	38	-	-
Debtors	16	13,810	14,132	16,944	22,002
Cash at Bank and in Hand		<u>11,555</u>	<u>10,655</u>	<u>7,402</u>	<u>4,090</u>
		25,386	24,825	24,346	26,092
Less: Creditors - Amounts falling due within one year	17	<u>(26,061)</u>	<u>(23,811)</u>	<u>(25,760)</u>	<u>(23,132)</u>
Net Current Assets / (Liabilities)		<u>(675)</u>	<u>1,014</u>	<u>(1,414)</u>	<u>2,960</u>
Total Assets Less Current Liabilities		106,756	104,626	97,801	93,544
Less: Creditors - Amounts falling due after more than one year	18	<u>(29,238)</u>	<u>(30,065)</u>	<u>(29,044)</u>	<u>(29,709)</u>
Less: Provisions for liabilities and charges	19	<u>(508)</u>	<u>(604)</u>	<u>(508)</u>	<u>(604)</u>
Net Assets Excluding Pension Liability		77,010	73,957	68,249	63,231
Pension Liability	31	<u>(11,743)</u>	<u>(13,465)</u>	<u>(11,607)</u>	<u>(13,305)</u>
NET ASSETS INCLUDING PENSION LIABILITY		<u>65,267</u>	<u>60,492</u>	<u>56,642</u>	<u>49,926</u>
Deferred Capital Grants	20	43,775	42,463	41,951	40,764
Specific Endowments	21	6,926	6,338	5,261	4,855
Restricted Funds	22	171	168	-	-
Investment Reserve	23	(5)	52	-	-
General Reserve	24	<u>26,143</u>	<u>24,936</u>	<u>21,037</u>	<u>17,612</u>
Total Funds Excluding Pension Liability		77,010	73,957	68,249	63,231
Pension Reserve	24	<u>(11,743)</u>	<u>(13,465)</u>	<u>(11,607)</u>	<u>(13,305)</u>
TOTAL FUNDS INCLUDING PENSION LIABILITY		<u>65,267</u>	<u>60,492</u>	<u>56,642</u>	<u>49,926</u>

The Financial Statements on pages 10 to 39 were approved by the University Court on 11th December 2006 and were signed its behalf by:-


Gavin J N Gemmell
Chairman of Court


Prof. John Simmons
Acting Principal & Chief Accounting Officer


Phil McNaull
Director of Finance & IS/IT

CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDING 31 JULY 2006

		2006	Re-stated 2005
	Note	£000	£000
Cash inflow from operating activities	26	4,744	5,959
Returns on investment and servicing of finance	27	(820)	(1,142)
Capital expenditure and financial investment	28	(2,340)	(2,358)
Financing	29	(684)	(669)
Increase in cash in the year		<u>900</u>	<u>1,790</u>

Reconciliation Of Net Cash Flow To Movement In Net Debt

Increase in cash in the year		900	1,790
Financing		<u>684</u>	<u>669</u>
Movement in net debt		1,584	2,459
Net debt brought forward		<u>(17,781)</u>	<u>(20,240)</u>
Net debt carried forward	30	<u>(16,197)</u>	<u>(17,781)</u>

NOTES TO THE ACCOUNTS FOR THE YEAR ENDING 31 JULY 2006

1. PRINCIPAL ACCOUNTING POLICIES

Fundamental accounting concept

The financial statements have been prepared on the going concern basis, with the parent undertaking having agreed to provide adequate funds, if required, so that all the undertakings within the group may meet their liabilities as they fall due.

Prior year adjustments

Since 2005 the group has implemented the transitional requirements of FRS 17 'Retirement Benefits'. During this period the group continued to account for pension costs under SSAP 24 'Accounting for Pensions Costs'. Full implementation of FRS 17 is mandatory for accounting periods starting on or after 1 January 2006. The effect of the change in accounting policy is disclosed in note 25 to the financial statements.

Since 2005 the group has implemented the requirements of FRS 21 'Events After the Balance Sheet Date'. The effect of this change in accounting policy is disclosed in note 25 to the financial statements.

Basis of preparation

These financial statements have been prepared in accordance with the Statement of Recommended Practice (SORP): Accounting for Further and Higher Education 2003 and in accordance with applicable accounting standards.

Basis of accounting

The financial statements are prepared in accordance with the historical cost accounting convention as modified by the revaluation of endowment asset investments.

Basis of consolidation

These financial statements, and associated notes, reflect the group income and expenditure account, statement of total recognised gains and losses and cash flow statement for the year ended 31 July. Balance sheets, and their associated notes, as at 31 July are prepared for the parent (Heriot-Watt University) and the group.

The group financial statements include the University and its subsidiaries, as detailed in notes 13 and 14, in compliance with FRS 2 'accounting for subsidiary undertakings' and FRS 9 'associates and joint ventures'. The results of subsidiaries acquired or disposed of during the year are included in the group income and expenditure account from the day of acquisition or up to the date of disposal.

All intra-group sales and profits are eliminated fully on consolidation.

In accordance with FRS 2 'accounting for subsidiary undertakings', the activities of the Heriot-Watt University Students' Union have not been consolidated, both on grounds of materiality and the fact that it is a separate legal entity in which the University has no financial interest and no control or significant influence over policy decisions.

Recognition of income

Income from tuition fees is recognised in the year for which it is received and includes all fees chargeable to students or their sponsors. The costs of any fees waived by the University and any scholarships given to students are included as expenditure in Note 10.

Income from grants, contracts and other services rendered is included to the extent of the completion of the contract or service concerned.

Income from donations is credited to the income and expenditure account in the year in which it is earned, unless specific restrictions apply.

All income from short-term deposits and endowments is credited to the income and expenditure account in the year in which it is earned.

Income from specific endowments not expended in accordance with the restrictions of the endowment is transferred from the income and expenditure account to specific endowments.

Research grants and contracts

Income from grants for sponsored research is included only to the extent of direct and indirect expenditure incurred on each project during the year.

Expenditure is written off in the year in which it is incurred except for equipment costing more than £5,000 which is capitalised in accordance with the group's capitalisation policy.

Other income received in advance is included in the balance sheet within creditors: amounts falling due within one year.

NOTES TO THE ACCOUNTS – continued**Retirement benefits**

All new members of staff have the option of joining a pension scheme. The schemes currently open to new members of staff are the Universities Superannuation Scheme (USS) and the Lothian Pension Fund (LPF).

Existing employees are entitled to maintain their membership of the Scottish Teachers Superannuation Scheme (STSS) and the Supplementary Pension Scheme (SPS).

Full provision has been made for those pension costs which do not arise from externally funded defined benefit schemes.

The subsidiary undertakings do not operate any other pension schemes. Employees of the subsidiary undertakings are members of the University's pension schemes. The amount charged against profits represents the contributions payable to the individual plans in respect of the year.

USS

Heriot-Watt University participates in the USS pension scheme providing benefits based on final pensionable pay. The assets of the scheme are held separately from those of Heriot-Watt University. Heriot-Watt University is unable to identify its share of the underlying assets and liabilities of the scheme on a consistent and reasonable basis and therefore, as required by FRS17 'Retirement Benefits', accounts for the scheme as if it were a defined contribution scheme. The amount charged to the income and expenditure account represents the contributions payable to the scheme in respect of the year.

LPF

The LPF is a pension scheme providing benefits based on final pensionable pay. The assets and liabilities of the scheme are held separately from those of Heriot-Watt University. Pension scheme assets are measured using market values. Pension scheme liabilities are measured using a projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. Contributions to the Scheme are calculated so as to spread the cost of pensions over employees' working lives with the University. The Contributions are determined by an actuary on the basis of triennial valuations using the Age Attained Method. Variations from regular cost are spread over the expected average remaining working lifetime of members of the schemes, after making allowances for future withdrawals. The amount charged to the statement of financial activities represents the service cost expected to arise from employee service in the current year.

STSS

Heriot-Watt University participates in the STSS pension scheme providing benefits based on final pensionable pay. The assets of the scheme are held separately from those of Heriot-Watt University. Heriot-Watt University is unable to identify its share of the underlying assets and liabilities of the scheme on a consistent and reasonable basis and therefore, as required by FRS17 'Retirement Benefits', accounts for the scheme as if it were a defined contribution scheme. As a result, the amount charged to the income and expenditure account represents the contributions payable to the scheme in respect of the year.

SPS

The SPS is a pension scheme providing benefits based on final pensionable pay. The assets and liabilities of the scheme are held separately from those of Heriot-Watt University. The last full actuarial valuation of this scheme was carried out by a qualified independent actuary as at 31 July 2004 and updated on an approximate basis to 31 July 2006. Pension scheme assets are measured using market values. Pension scheme liabilities are measured using a projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. The Contributions are determined by an actuary on the basis of triennial valuations using the Age Attained Method. The amount charged to the income and expenditure account represents the contributions payable to the scheme in respect of the year.

Leased assets

Costs in respect of operating leases are charged on a straight-line basis over the lease term. Leasing agreements, which transfer to the group substantially all the benefits and risks of ownership of an asset, are treated as if the asset has been purchased outright. The assets are included in fixed assets and the capital elements of the leasing commitments are shown as obligations under finance leases. The lease rentals are treated as consisting of capital and interest elements.

The capital element is applied in order to reduce outstanding obligations and the interest element is charged to the income and expenditure account in proportion to the reducing capital element outstanding. Assets held under finance leases are depreciated over the shorter of the lease term or the useful economic lives of equivalent owned assets.

NOTES TO THE ACCOUNTS – continued

Tangible fixed assets

Land and buildings are included in the balance sheet at historical cost and are depreciated on a straight line basis over their expected useful economic life of 50 years. Freehold land is not depreciated. Where land and buildings are acquired or built with the aid of specific grants they are capitalised and depreciated as above.

Equipment costing less than £5,000 per individual item or group of related items is written off to the income and expenditure account in the year of acquisition. All other equipment is capitalised at cost.

Capitalised equipment is depreciated on a straight line basis over its expected useful economic life as follows:

Plant	- 15 years
General equipment	- 5 years
Computers	- 5 years
Furniture & fittings	- 5 years
Motor vehicles	- 4 years

Capitalised equipment for sponsored research is depreciated on a straight line basis over the life of the related research grant or contract.

Assets under construction are included in the balance sheet at cost.

Intangible Fixed Assets

Costs incurred by the Edinburgh Business School in the production of courses and in the translation of existing courses into non-English languages are recognised in the period in which they occur. Similar costs incurred by a third party and subsequently purchased by the Business School have been capitalised and written down over a period of 4 years, the expected economic life of the course

Capital grants

Capital grants received are credited to a deferred capital grant creditor and are released to the income and expenditure account over the expected useful economic life of the related asset on a basis consistent with the depreciation policy.

Investments

Listed investments held as fixed assets or endowment assets are stated at market value. Current asset investments, which may include listed investments, are stated at the lower of their cost and net realisable value.

Stocks

Stocks are stated at the lower of their cost and net realisable value. Where necessary, provision is made for obsolete, slow-moving and defective stocks.

Maintenance of premises

The cost of routine corrective maintenance is charged to the income and expenditure account in the period that it is incurred.

Foreign currency translation

Assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the end of the financial year, with all resulting exchange differences being taken to the income and expenditure account in the period in which they arise. Transactions denominated in foreign currencies are recorded at the rate of exchange ruling at the date of the transaction.

Provisions

Provisions are recognised when the group has a present legal or constructive obligation as a result of a past event, it is probable that a transfer of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Taxation

The University is an exempt charity within the meaning of schedule 2 of the Charities Act 1993 and as such is a charity within the meaning of section 506(1) of the Income and Corporation Taxes Act (ICTA 1988).

Accordingly, the University is potentially exempt from taxation in respect of income or capital gains received within categories covered by section 505 of the ICTA 1988 or section 256 of the Taxation of Chargeable Gains Act 1992, to the extent that such income or gains are applied to exclusively charitable purposes. The subsidiaries, excluding the Edinburgh Business School, transfer their annual profits to the University by gift aid. In certain circumstances Value Added Tax is recoverable, but where this is not possible the cost is included in the relevant expenditure.

Gift Aid

Gift Aid payments and receipts are recognised in the income and expenditure account in the year in which they are made.

NOTES TO THE ACCOUNTS – continued**2. FUNDING COUNCIL GRANTS**

	2006 £000	Group 2005 £000
Recurrent Teaching Grant	23,078	22,371
Funding for Increased STSS Contributions	67	65
Recurrent Research Grant	10,263	9,630
LTIF Grants	138	-
Release of Deferred Capital Grants	1,378	1,307
Other Grants	630	553
	<u>35,554</u>	<u>33,926</u>

3. TUITION FEES AND EDUCATION CONTRACTS

	2006 £000	Group 2005 £000
UK Higher education students	6,740	7,052
European Union students (ex. UK)	1,702	1,598
Non European Union students	11,011	10,094
Higher education contracts	3,915	956
Research training support grants	2,139	1,698
Short course fees	1,402	1,354
Examination and graduation fees	1,567	1,322
	<u>28,476</u>	<u>24,074</u>

NOTES TO THE ACCOUNTS – continued**4. RESEARCH GRANTS AND CONTRACTS**

	2006	Group 2005
	£000	£000
Research councils	6,463	6,243
Charities	375	232
UK government	1,310	1,797
UK industry	3,604	3,951
EU Commission	1,398	1,481
Other sources	1,973	1,355
	<u>15,123</u>	<u>15,059</u>

5. OTHER INCOME

	2006	Group 2005
	£000	£000
Residences, catering and conferences	10,827	11,475
Other services rendered	3,373	2,996
Royalties	402	2,293
Donations	956	1,213
Release from deferred capital grants	298	189
Other income	3,561	2,623
	<u>19,417</u>	<u>20,789</u>

6. ENDOWMENT AND INVESTMENT INCOME

	2006	Group 2005
	£000	£000
Income from specific endowment assets	334	213
Net return on pension assets	82	-
Other investment income	16	84
Other interest receivable	543	491
	<u>975</u>	<u>788</u>

7. STAFF COSTS

	2006	Group Re-stated 2005
	£000	£000
Wages and salaries	46,668	44,486
Social security costs	3,930	3,695
Other pension costs	6,200	5,621
	<u>56,798</u>	<u>53,802</u>

NOTES TO THE ACCOUNTS – continued*Staff Costs (continued)*

Analysed between:

	Group	
	2006	Re-stated
	£000	£000
Academic	21,719	20,872
Academic support	16,957	16,180
Other support	1,111	1,135
Administrative & central services	9,559	8,861
Estates	3,290	3,069
Catering and residences	3,907	3,629
Other	255	56
	<u>56,798</u>	<u>53,802</u>

The average monthly number of persons employed by the group during the year, expressed as full-time equivalents, was:

	Number	Number
Academic	381	375
Academic support	512	509
Other support	36	38
Administrative & central services	255	246
Estates	122	142
Catering and residences	204	172
Other	17	18
	<u>1,527</u>	<u>1,500</u>

The number of staff who received emoluments in the following ranges was:

	2006	2005
	£000	£000
£70,001 - £80,000	10	7
£80,001 - £90,000	6	11
£90,001 - £100,000	11	5
£100,001 - £110,000	3	2
£110,001 - £120,000	1	-
£120,001 - £130,000	1	-
£130,001 - £140,000	-	1
£180,001 - £190,000	-	1
£190,001 - £200,000	1	-
	<u>33</u>	<u>27</u>

NOTES TO THE ACCOUNTS – continued*Staff Costs (continued)*

The above emoluments include amounts payable to the Principal by Heriot-Watt University of:

	2006 £000	2005 £000
Salary	181	172
Benefits in kind	12	9
	<u>193</u>	<u>181</u>
Pension contributions	<u>25</u>	<u>24</u>

The pension contributions are in respect of the Universities Superannuation Scheme (USS) and are paid at the same rate as for other employees.

Costs of £1,609 were incurred by the Principal during the year in respect of overseas activities carried out in pursuance of the strategy approved by the governing body.

8. OTHER OPERATING EXPENSES

	Group 2006 £000	2005 £000
Other operating expenses include:		
* External auditors' remuneration - audit	60	41
External auditors' remuneration - non-audit services	43	20
** Internal auditors' remuneration	63	51
(Profit) / Loss on disposal of tangible fixed assets	(5)	(41)
Hire of other assets - operating leases - other	513	502
Finance lease charges	3	3
* Inc. £40,900 for Heriot-Watt University		
** Inc. £63,000 for Heriot-Watt University		

9. INTEREST PAYABLE

	Group 2006 £000	Re-stated 2005 £000
Finance lease interest	3	3
Net return on pension assets	-	198
On bank loans:		
Repayable within 5 years, by instalments	2	2
Repayable wholly or partly in more than 5 years	1,591	1,567
	<u>1,596</u>	<u>1,770</u>

NOTES TO THE ACCOUNTS – continued

10. ANALYSIS OF EXPENDITURE BY ACTIVITY

	Group - 2006				
	Staff	Dep'n.	Other	Interest	Total
	Costs £000		Operating Expenses £000	Payable £000	
Academic departments	29,950	745	5,823	-	36,518
Academic services	2,629	111	2,105	-	4,845
General educational	1,243	-	4,572	-	5,815
Premises	3,242	2,526	5,350	-	11,118
Administration	6,388	224	2,089	-	8,701
Student facilities	1,389	46	1,459	-	2,894
Other expenses	70	-	-	1,596	1,666
Research grants and contracts	6,591	572	6,672	-	13,835
Residences, catering and conference	3,909	29	4,679	-	8,617
Other services rendered	1,387	16	1,148	-	2,551
Equipment	-	-	1,741	-	1,741
Total per Income and Expenditure Account	<u>56,798</u>	<u>4,269</u>	<u>35,638</u>	<u>1,596</u>	<u>98,301</u>

	Group - 2005 – Re-stated				
	Staff	Dep'n.	Other	Interest	Total
	Costs £000		Operating Expenses £000	Payable £000	
Academic departments	28,452	786	5,548	-	34,786
Academic services	2,559	45	1,751	-	4,355
General educational	780	-	2,084	-	2,864
Premises	3,420	1,561	4,792	-	9,773
Administration	6,434	259	2,619	-	9,312
Student facilities	1,330	47	1,484	-	2,861
Other expenses	71	3	13	1,770	1,857
Research grants and contracts	6,529	579	7,659	-	14,767
Residences, catering and conference	3,074	817	5,313	-	9,204
Other services rendered	1,153	21	1,337	-	2,511
Equipment	-	-	701	-	701
Total per Income and Expenditure Account	<u>53,802</u>	<u>4,118</u>	<u>33,301</u>	<u>1,770</u>	<u>92,991</u>

NOTES TO THE ACCOUNTS – continued

11. TANGIBLE FIXED ASSETS

		Freehold Land and Buildings £000	Equipment £000	Total £000
Group				
Cost				
At 1 August 2005		122,128	21,245	143,373
Additions		3,607	1,788	5,395
Disposals		(70)	(227)	(297)
At 31 July 2006		<u>125,665</u>	<u>22,806</u>	<u>148,471</u>
Depreciation				
At 1 August 2005		31,159	15,334	46,493
Charge for year		2,404	1,865	4,269
Eliminated on disposals		(70)	(195)	(265)
At 31 July 2006		<u>33,493</u>	<u>17,004</u>	<u>50,497</u>
Net Book Value	At 31 July 2006	<u>92,172</u>	<u>5,802</u>	<u>97,974</u>
	At 1 August 2005	<u>90,969</u>	<u>5,911</u>	<u>96,880</u>
Analysed between:				
		£000	£000	£000
Funded by capital grants		39,371	1,489	40,860
Own funded		52,801	4,313	57,114
At 31 July 2006		<u>92,172</u>	<u>5,802</u>	<u>97,974</u>
		Freehold Land and Buildings £000	Equipment £000	Total £000
University				
Cost				
At 1 August 2005		110,355	20,585	130,940
Additions		3,605	1,584	5,189
Eliminated on disposals		(70)	(161)	(231)
At 31 July 2006		<u>113,890</u>	<u>22,008</u>	<u>135,898</u>
Depreciation				
At 1 August 2005		30,410	14,987	45,397
Charge for year		2,170	1,794	3,964
Eliminated on Disposals		(70)	(161)	(231)
At 31 July 2006		<u>32,510</u>	<u>16,620</u>	<u>49,130</u>
Net Book Value	At 31 July 2006	<u>81,380</u>	<u>5,388</u>	<u>86,768</u>
	At 1 August 2005	<u>79,945</u>	<u>5,598</u>	<u>85,543</u>

NOTES TO THE ACCOUNTS – continued*Tangible Fixed Assets (continued)*

Analysed between:

	£000	£000	£000
Funded by capital grants	37,550	1,486	39,036
Own funded	43,830	3,902	47,732
At 31 July 2006	<u>81,380</u>	<u>5,388</u>	<u>86,768</u>

The net book value of the group's tangible fixed assets includes an amount of £41,230 (2005 - £55,138) in respect of assets held under finance leases. The depreciation charge on these assets for the year was £13,908 (2005 - £13,908).

The land and buildings of Heriot-Watt Sports Village Ltd are subject to a first standard security in respect of the grants received from Sportscotland.

12. INTANGIBLE FIXED ASSETS

		Course materials £000	Total £000
Group			
Cost			
At 1 August 2005		-	-
Additions		524	524
At 31 July 2006		<u>524</u>	<u>524</u>
Amortisation			
At 1st August 2005		-	-
Charge for year		308	308
At 31 July 2006		<u>308</u>	<u>308</u>
Net Book Value	At 31 July 2006	<u>216</u>	<u>216</u>
	At 1 August 2005	<u>-</u>	<u>-</u>

13. INVESTMENTS

	Group		University	
	2006	2005	2006	2005
	£000	£000	£000	£000
Listed investments on the London Stock Exchange	2,260	307	-	-
Investment in subsidiary companies at cost	-	-	7,131	131
Minority investments in unquoted companies	55	87	55	55
	<u>2,315</u>	<u>394</u>	<u>7,186</u>	<u>186</u>

Investment in subsidiary companies has risen significantly as a consequence of actions taken during the year to improve the capital structure of the group's trading subsidiaries to allow them to enhance their commercial operations.

Minority investments in unquoted companies include investments made by the group in spin-out companies, which are stated at cost.

NOTES TO THE ACCOUNTS – continued

14. SUBSIDIARY UNDERTAKINGS

	Number of shares	Percentage owned
The group has major shareholdings in the following companies:		
Edinburgh Business School (Limited by Guarantee)	-	100%
Edinburgh Conference Centre Limited	2,100,000	100%
* Heriot-Watt Properties Limited	2	100%
* Heriot-Watt Services Limited	2	100%
Heriot-Watt Sports Village Limited	5,000,100	100%
Heriot-Watt Trading Limited	5,000	100%
* Interactive University Press Limited	2	100%
* SCOT Innovation and Development Limited	80,000	100%
** SISTech Limited	250	50%
* Scottish College of Textiles Limited	6	100%
*** The Interactive University	-	33%
* The Scottish Director Centre Limited	2	100%

The consolidated financial statements of the group include the transactions of the above companies, with the exception of those marked with an asterisk.

* These companies are dormant.

** For SISTech Limited the figures are not consolidated as they are deemed to be insignificant.

*** For The Interactive University the figures are not consolidated as the group has neither control / influence over the organisation's activities nor a right / obligation to a share of the financial profits / losses.

The group has an investment in EBS Americas for which the figures are not consolidated because they are insignificant.

15. ENDOWMENT ASSETS

	Group		University	
	2006 £000	2005 £000	2006 £000	2005 £000
Balance at 1 August	6,338	5,450	4,855	4,210
Increase in cash balances held	207	178	207	178
Appreciation of endowment asset investments	381	710	199	467
Balance at 31 July	<u>6,926</u>	<u>6,338</u>	<u>5,261</u>	<u>4,855</u>
Represented by:				
Equities (listed)	6,080	5,699	4,415	4,216
Cash balances	846	639	846	639
	<u>6,926</u>	<u>6,338</u>	<u>5,261</u>	<u>4,855</u>

NOTES TO THE ACCOUNTS – continued

16. DEBTORS

	Group		University	
	2006	2005	2006	2005
	£000	£000	£000	£000
Trade debtors	4,112	3,476	2,658	2,264
Research debtors	7,259	7,081	7,259	7,081
Loans by parent undertaking	-	-	3,904	8,957
Amounts owed by group undertakings	-	-	992	1,314
Prepayments and accrued income	2,439	3,575	2,131	2,386
	<u>13,810</u>	<u>14,132</u>	<u>16,944</u>	<u>22,002</u>

Included in loans by parent undertaking is £nil (2005: £5,000,000) due by Heriot-Watt Sports Village Ltd to Heriot-Watt University and £3,904,000 (2005: £3,931,000) due by Edinburgh Conference Centre Ltd to Heriot-Watt University that is due after more than one year.

17. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group		University	
	2006	2005	2006	2005
	£000	£000	£000	£000
Bank loans	668	667	668	667
Loans from subsidiary companies	-	-	1,000	1,000
Obligations under finance leases	19	19	-	-
Grants in advance for research	11,965	9,236	11,965	9,236
Grants in advance from SFC	563	724	563	724
Other creditors	51	51	-	-
Trade creditors	2,143	1,698	2,094	1,617
Other taxation and social security	2,428	2,708	2,312	2,258
Accruals and deferred income	8,224	8,708	7,158	7,630
	<u>26,061</u>	<u>23,811</u>	<u>25,760</u>	<u>23,132</u>

NOTES TO THE ACCOUNTS – continued

18. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	Group		University	
	2006	2005	2006	2005
	£000	£000	£000	£000
Bank loans	27,044	27,709	27,044	27,709
Loans from subsidiary companies	-	-	2,000	2,000
Obligations under finance leases (between 2 to 5 years)	21	41	-	-
Deferred income	1,930	2,019	-	-
Other creditors	243	296	-	-
	<u>29,238</u>	<u>30,065</u>	<u>29,044</u>	<u>29,709</u>
The above loans are repayable as follows:				
In one year or less (note 17)	<u>668</u>	<u>667</u>	<u>1,668</u>	<u>1,667</u>
Between one and two years	668	670	668	670
Between two and five years	5,954	3,707	7,954	5,037
In five years or more	<u>20,422</u>	<u>23,332</u>	<u>20,422</u>	<u>24,002</u>
	<u>27,044</u>	<u>27,709</u>	<u>29,044</u>	<u>29,709</u>
	<u>27,712</u>	<u>28,376</u>	<u>30,712</u>	<u>31,376</u>

Bank loans comprise £18.9 million, repayable by instalments between 2008 and 2016, at rates of between 5.05% and 5.62% and £8.8 million, repayable by instalments between 2004 and 2020, at a rate of 5.45%.

Loans from subsidiary companies comprises £3,000,000 (2005: £3,000,000) with £2,000,000 (2005: £2,000,000) due after more than one year, repayable in full by 31 July 2009, at a rate of 1.5% over the bank base rate.

NOTES TO THE ACCOUNTS – continued

19. PROVISIONS FOR LIABILITIES AND CHARGES

	Group and University Pensions	Total
	£000	£000
At 1 August 2005	604	604
Utilised during the year	(96)	(96)
At 31 July 2006	<u>508</u>	<u>508</u>
To be spent before 31 July 2007	<u>34</u>	<u>34</u>

20. DEFERRED CAPITAL GRANTS

	Funding Council £000	Other Grants and Benefactions £000	Total £000
Group			
At 1 August 2005			
Buildings	29,716	9,860	39,576
Equipment	2,197	690	2,887
Total	<u>31,913</u>	<u>10,550</u>	<u>42,463</u>
Cash Received			
Buildings	929	170	1,099
Equipment	2,254	324	2,578
Total	<u>3,183</u>	<u>494</u>	<u>3,677</u>
Transfers			
Buildings	(628)	-	(628)
Equipment	628	-	628
Total	<u>-</u>	<u>-</u>	<u>-</u>
Released to Income and Expenditure			
Buildings	(900)	(262)	(1,162)
Equipment	(616)	(587)	(1,203)
Total	<u>(1,516)</u>	<u>(849)</u>	<u>(2,365)</u>
At 31 July 2006			
Buildings	29,117	9,768	38,885
Equipment	4,463	427	4,890
Total	<u>33,580</u>	<u>10,195</u>	<u>43,775</u>

NOTES TO THE ACCOUNTS – continued*Deferred Capital Grants (continued)***University**

At 1 August 2005

Buildings	29,653	8,228	37,881
Equipment	2,197	686	2,883
Total	<u>31,850</u>	<u>8,914</u>	<u>40,764</u>

Cash Received

Buildings	927	-	927
Equipment	2,254	324	2,578
Total	<u>3,181</u>	<u>324</u>	<u>3,505</u>

Transfers

Buildings	(628)	-	(628)
Equipment	628	-	628
Total	<u>-</u>	<u>-</u>	<u>-</u>

Released to Income and Expenditure

Buildings	(898)	(219)	(1,117)
Equipment	(616)	(585)	(1,201)
Total	<u>(1,514)</u>	<u>(804)</u>	<u>(2,318)</u>

At 31 July 2006

Buildings	29,054	8,009	37,063
Equipment	4,463	425	4,888
Total	<u>33,517</u>	<u>8,434</u>	<u>41,951</u>

21. ENDOWMENTS

	Group		University	
	Specific	Specific	Specific	Specific
	2006	2005	2006	2005
	£000	£000	£000	£000
At 1 August	6,338	5,450	4,855	4,210
Additions	72	60	72	60
Appreciation of endowment asset investments	381	710	199	467
Income for year	334	213	334	213
Expenditure for the year	(199)	(95)	(199)	(95)
At 31 July	<u>6,926</u>	<u>6,338</u>	<u>5,261</u>	<u>4,855</u>
Representing:				
Fellowship and scholarship funds	2,043	1,789	2,043	1,789
Prize funds	602	542	602	542
Chairs and lectureship funds	2,745	2,421	1,080	938
Other funds	1,536	1,586	1,536	1,586
	<u>6,926</u>	<u>6,338</u>	<u>5,261</u>	<u>4,855</u>

NOTES TO THE ACCOUNTS – continued

22. RESTRICTED FUNDS

	Group		University	
	2006	2005	2006	2005
	£000	£000	£000	£000
Balance at 1 August	168	164	-	-
Income in the year	3	65	-	-
Expenditure in the year	-	(61)	-	-
Balance at 31 July	<u>171</u>	<u>168</u>	<u>-</u>	<u>-</u>

23. INVESTMENT RESERVE

	Group		University	
	2006	2005	2006	2005
	£000	£000	£000	£000
Balance at 1 August	52	-	-	-
Revaluation for the year	(57)	52	-	-
Balance at 31 July	<u>(5)</u>	<u>52</u>	<u>-</u>	<u>-</u>

24. GENERAL RESERVE

	Group		University	
	2006	Re-stated 2005	2006	Re-stated 2005
	£000	£000	£000	£000
Reported Balance at 1 August	24,734	22,991	18,620	16,706
Prior year adjustment (gift aid)	-	-	(1,210)	(115)
Prior year adjustment (pensions)	(13,263)	(11,050)	(13,103)	(10,941)
Re-stated balance at 1 August	11,471	11,941	4,307	5,650
Net surplus retained for the year	1,111	1,564	3,321	626
Transfer from reserves	1,818	(2,034)	1,802	(1,969)
Balance at 31 July	<u>14,400</u>	<u>11,471</u>	<u>9,430</u>	<u>4,307</u>

	Group	
	2006	Re-stated 2005
	£000	£000
The net surplus retained for the year is analysed as follows:		
University surplus / (deficit)	709	(18)
Gift Aid from subsidiaries	2,619	315
(Deficit) / Surplus retained by subsidiaries	(2,217)	1,267
	<u>1,111</u>	<u>1,564</u>

NOTES TO THE ACCOUNTS – continued*General Reserve (continued)*

	Group		University	
	2006	Re-stated 2005	2006	Re-stated 2005
	£000	£000	£000	£000
(Deficit) at end of the year				
Reconciliation:				
Income and expenditure reserve	26,143	24,936	21,037	17,612
Pension reserve	(11,743)	(13,465)	(11,607)	(13,305)
Balance at 31 July	<u>14,400</u>	<u>11,471</u>	<u>9,430</u>	<u>4,307</u>
Represented by:				
	Group		University	
	2006		2006	
	£000		£000	
Income and expenditure account				
At 1 August as re-stated	24,936		17,612	
Surplus for the year	1,111		3,321	
Transfer from pension reserve	96		104	
At 31 July	<u>26,143</u>		<u>21,037</u>	
	Group		University	
	2006		2006	
	£000		£000	
Pension Reserve				
Deficit at 1 August as re-stated	(13,465)		(13,305)	
Current service cost	(1,892)		(1,839)	
Employer contributions	1,699		1,643	
Contributions in respect of unfunded benefits	15		15	
Net return on assets	82		77	
Actuarial gains	1,818		1,802	
Deficit at 31 July	<u>(11,743)</u>		<u>(11,607)</u>	

25. PRIOR YEAR ADJUSTMENTS

Full implementation of FRS 21 'Events After the Balance Sheet Date' during the year ended 31 July 2006 requires a prior year adjustment to the opening reserves of the group at 1 August 2004 and the 2004-05 comparatives. The following table identifies balances re-stated in these financial statements.

		Reported in 2004 - 05	Adjustment	Re-stated
	Note	£000	£000	£000
Balance Sheet				
Debtors	15	23,212	(1,210)	22,002
General Reserve	23	(18,620)	1,210	(17,410)

NOTES TO THE ACCOUNTS – continued*Prior Year Adjustments (continued)*

Full implementation of FRS 17 'Retirement Benefits' during the year ended 31 July 2006 requires a prior year adjustment to the opening reserves at 1 August 2004 and the 2004-05 comparatives. The following table identifies balances re-stated in these financial statements.

		Reported in 2004 - 05	Adjustment	Re-stated
	Note	£000	£000	£000
Income and Expenditure Account				
Staff costs	7	53,821	(19)	53,802
Interest payable	9	1,572	198	1,770
STRGL				
Actuarial loss		-	2,034	2,034
Balance Sheet				
Provisions for liabilities and charges	19	(943)	215	(728)
Pension liability	31	-	(11,265)	(11,265)
General reserve	24	(22,991)	11,050	(11,941)

26. RECONCILIATION OF OPERATING RESULT TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	Group	
	2006	2005
	£000	£000
Surplus on continuing operations after depreciation and disposal of assets and taxation	1,249	1,682
Depreciation and amortisation	4,577	4,118
(Profit) on disposal of tangible fixed assets	(5)	(37)
Deferred capital grants released to income	(2,365)	(1,627)
Interest receivable	(559)	(510)
Interest payable	1,596	1,572
Transfer from accumulated income to specific endowments and restricted funds	(138)	(118)
Pension charges	96	166
Net return on pension assets	(82)	198
(Increase) in fixed asset investments	(1,921)	(36)
Decrease in stocks	17	15
Decrease / (increase) in debtors	322	(4,873)
Increase in creditors	2,107	5,477
(Decrease) in provisions	(96)	(124)
Increase in restricted funds	3	4
(Decrease) / Increase in investment reserve	(57)	52
Net Cash Inflow from Operating Activities	<u>4,744</u>	<u>5,959</u>

NOTES TO THE ACCOUNTS – continued**27. RETURNS ON INVESTMENT AND SERVICING OF FINANCE**

	Group	
	2006	Re-stated 2005
	£000	£000
Income received on specific endowments	334	213
Expenditure paid on specific endowments	(199)	(95)
Interest received	540	491
Income received on restricted funds	3	-
Other investment income received	16	19
Interest paid	(1,596)	(1,572)
Net return on pension assets	82	(198)
Net Cash (Outflow) from Returns on Investment and Servicing of Finance	<u>(820)</u>	<u>(1,142)</u>

28. CAPITAL EXPENDITURE AND FINANCIAL INVESTMENT

	Group	
	2006	2005
	£000	£000
Purchase of tangible fixed assets	(5,395)	(5,672)
Proceeds on disposal of tangible fixed assets	37	91
Purchase of intangible fixed assets	(524)	-
Payments to acquire endowment assets	(207)	(178)
Deferred capital grants received	3,677	3,341
Endowments received	72	60
Net Cash Outflow from Capital Expenditure and Financial Investment	<u>(2,340)</u>	<u>(2,358)</u>

29. FINANCING

	Group	
	2006	2005
	£000	£000
Repayment of amounts borrowed	(664)	(667)
Capital element of finance lease rentals paid	(20)	(2)
Net Cash Outflow from Financing	<u>(684)</u>	<u>(669)</u>

NOTES TO THE ACCOUNTS – continued

30. ANALYSIS OF CHANGES IN NET DEBT

	At 1 August 2005	Cash Flows	Other Changes	At 31 July 2006
	£000	£000	£000	£000
Cash at bank and in hand	10,655	900	-	11,555
	<u>10,655</u>	<u>900</u>	<u>-</u>	<u>11,555</u>
Debt due within one year	(667)	664	(665)	(668)
Debt due after one year	(27,709)	-	665	(27,044)
Finance leases	(60)	20	-	(40)
	<u>(17,781)</u>	<u>1,584</u>	<u>-</u>	<u>(16,197)</u>

Had the cash held under endowment asset investments been included above, the net cash inflow would have been £1,791,000 with net debt at 31 July 2006 of £15,351,000 as compared with £17,142,000 as at 31 July 2005. However, to reflect more accurately the restricted nature of the cash held for endowments the group considers the exclusion of this cash from the above figures gives a fairer view of the group's net debt.

31. PENSION SCHEMES

The total pension charge in the financial statements reflects the costs incurred by the group during the year of £6,200,000 (2005 - £5,621,000).

	Group	
	2006	Re-stated 2005
	£000	£000
The total pension charge is analysed as follows:		
Universities Superannuation Scheme	4,204	3,992
Lothian Pension Fund	1,900	1,532
Scottish Teachers Superannuation Scheme	96	97
	<u>6,200</u>	<u>5,621</u>

The pension costs are assessed in accordance with the advice of independent qualified actuaries using the projected unit method. The latest actuarial valuation of the Lothian Pension Fund (LPF) scheme was as at 31st March 2005, and the USS at 31st March 2005.

In accordance with FRS17 'Retirement Benefits' the total pension charge disclosed for LPF is the current service cost which represents the increase in the present value of the scheme's liabilities expected to arise from employee service in the current year.

NOTES TO THE ACCOUNTS – continued

Pension Schemes (continued)

Universities Superannuation Scheme

The USS operates on a notionally funded basis. It is a multi-employer scheme and it is not possible to identify each institution's share of the notional assets and liabilities. Therefore, contributions to the scheme are accounted for as if it were a defined contribution scheme. The cost recognised within the results for the year is the contribution payable to the scheme for that year.

The scheme is contracted out of the State Earnings-Related Pension scheme.

The total contribution made for the year ended 31 July 2006 was £6,111,000 (2005: £5,795,000), of which employer's contributions totalled £4,204,000 (2005: £3,992,000) and employee's contributions totalled £1,907,000 (2005: £1,803,000). The agreed contribution rates for future years are 14% (2005: 14%) for employers and 6.35% (2005: 6.35%) for employees.

Latest actuarial valuation	31 March 2005
Actuarial method	Projected Unit
Rate of return on investments	6.2% per annum
Rate of increase in salaries	3.9% per annum
Inflation assumption	2.9% per annum
Market value of assets	£21,740 million

Lothian Pension Fund

A full actuarial valuation was carried out at 31 March 2005 by a qualified independent actuary.

The major assumptions used by the actuary were:

	2006	2005
Price increases	3.1%	2.8%
Salary increases	4.6%	4.3%
Pension increases	3.1%	2.8%
Discount rate	5.1%	5.0%

The assets in the scheme and the expected rate of return at the last actuarial review date were:

	Long term rate of return	Assets at 31 July 2006	Long term rate of return	Assets at 31 July 2005
	% p.a.	£000	% p.a.	£000
Equities	7.7%	36,053	7.3%	32,508
Bonds	4.7%	2,712	4.7%	2,853
Property	5.7%	5,035	5.4%	4,282
Cash	4.8%	1,464	4.5%	812
Total	7.2%	<u>45,264</u>	6.9%	<u>40,455</u>

NOTES TO THE ACCOUNTS – continued*Pension Schemes (continued)*

The following amounts represent Heriot-Watt University's share of the scheme at 31 July 2006 and were measured in accordance with the requirements of FRS 17:

	2006 £000	2005 £000
Estimated employer assets (A)	<u>45,264</u>	<u>40,455</u>
Present value of liabilities	56,744	53,680
Present value of unfunded liabilities	<u>263</u>	<u>240</u>
Total value of liabilities (B)	<u>57,007</u>	<u>53,920</u>
Net pension liability (A-B)	<u>(11,743)</u>	<u>(13,465)</u>

Analysis Of Amount Charged To Operating Profit

	2006 £'000	2006 % of payroll	2006 £'000	2006 % of payroll
Amount charged to operating profit (A)				
Service cost	1,892	20.7%	1,526	17.4%
Settlements and curtailments	-	-	7	0.1%
Total Operating Charge (A)	<u>1,892</u>	20.7%	<u>1,533</u>	17.5%

Analysis Of Amount Credited To Other Finance Income

	2006 £'000	2006 % of payroll	2006 £'000	2006 % of payroll
Expected return on employer assets	2,667	29.2%	2,360	27.6%
Interest on pension scheme liabilities	(2,585)	(28.3)%	(2,558)	(29.9)%
Net Return (B)	<u>82</u>	0.9%	<u>(198)</u>	(2.3)%
Estimated net revenue account cost (A)-(B)	<u>1,810</u>	19.8%	<u>1,731</u>	20.2%

Analysis Of Amount Recognised In The Statement Of Total Recognised Gains And Losses (STRGL)

	2006 £000	2005 £000
Actual return less expected return on pension scheme assets	3,140	4,800
Experience gains / (losses) arising on the scheme liabilities	689	(12)
Changes in assumptions underlying the present value of the scheme liabilities	(2,011)	(6,822)
Actuarial gain / (loss) in pension plan	<u>1,818</u>	<u>(2,034)</u>
Actuarial gain / (loss) recognised in STRGL	<u>1,818</u>	<u>(2,034)</u>

NOTES TO THE ACCOUNTS – continued*Pension Schemes (continued)*

Movement In Deficit During The Year

	2006 £000	2005 £000
(Deficit) at start of the year	(13,465)	(11,265)
Current service cost	(1,892)	(1,526)
Employer contributions	1,699	1,551
Contributions in respect of unfunded benefits	15	14
Impact of settlements and curtailments	-	(7)
Net return on pension assets	82	(198)
Actuarial gains / (losses)	1,818	(2,034)
(Deficit) at end of the year	<u>(11,743)</u>	<u>(13,465)</u>

History Of Experience Gains And Losses

	2006 £000	2005 £000
Difference between expected and actual return on assets	3,140	4,800
Value of assets	45,264	40,455
Percentage of assets	6.9%	11.9%
Experience gains / (losses) on liabilities	689	(12)
Total present value of liabilities	57,007	53,920
Percentage of the total present value of liabilities	1.2%	0.0%
Actuarial gains / (losses) recognised in STRGL	1,818	(2,034)
Total present value of liabilities	57,007	53,920
Percentage of the total present value of liabilities	3.2%	(3.8%)

NOTES TO THE ACCOUNTS – continued*Pension Schemes (continued)***Scottish Teachers Superannuation Scheme**

The STSS operates on a notionally funded basis. It is a multi-employer scheme and it is not possible to identify each institution's share of the notional assets and liabilities. Therefore, contributions to the scheme are accounted for as if it were a defined contribution scheme. The cost recognised within the results for the year is the contribution payable to the scheme for that year.

The scheme is contracted out of the State Earnings-Related Pension scheme.

The total contribution made for the year ended 31 July 2006 was £142,000 (2005: £144,000), of which employer's contributions totalled £96,000 (2005: £97,000) and employee's contributions totalled £46,000 (2005: £47,000). The agreed contribution rates for future years are 13.5% (2005: 12.5%) for employers and 6% (2005: 6%) for employees. (Effective from 1st April 2006 the employer contribution rates were increased from 12.5% to 13.5%).

The last actuarial valuation of the scheme for which information is available was at 31st March 2001. The assumptions that have had the most significant effect on this valuation and other relevant information are as follows below.

Rate of return on investments in excess of rate of increases in earnings	2.0% per annum
Rate of return on investments in excess of rate of increases in prices	3.5% per annum
Market value of the assets at 31st March 2001	£4,433 million

As at 31st March 2001 actuarial valuation date, which was carried out using the prospective benefit method, the STSS showed that the present value of liabilities exceeded assets by £10,769 million. As such notional investments totalling £10,769 million are required to be credited to the scheme to balance the account.

The 2001 actuarial valuation date was carried out using an approach known as 'superannuation contributions adjusted for past experience' (SCAPE). Using SCAPE, with effect from 1st April 2001, the notional investments will earn a real rate of return (in excess of price increases) specified by the Government Actuary. In addition, the Teachers Superannuation (Scotland) Amendment Act 2003 states that, for the purposes of the actuarial review as at 31st March 2001, the balance in the account at that date shall be such that the value of the scheme's assets equals the value of the scheme's liabilities.

Supplementary Pension Scheme

The SPS operates on a funded basis. The scheme has no active members, with all the members of the scheme during the year being pensioners with pensions in payment.

The valuation of the SPS indicates a notional deficiency for which a provision is included in note 20.

The assets have been valued at market value. The liabilities have been calculated using the following principal actuarial assumptions:

Latest actuarial valuation	31 July 2004
Price increases	3.1% per annum
Pension increases	3.1% per annum
Discount rate	5.1% per annum
Market value of assets at 31 July 2006	£953,000
Funding level	93%

32. POST BALANCE SHEET EVENTS

There are no material post Balance Sheet events.

NOTES TO THE ACCOUNTS – continued**33. CAPITAL COMMITMENTS**

	Group	
	2006	2005
	£000	£000
Commitments contracted	1,707	1,559
Authorised but not contracted	8,798	-
	<u>10,505</u>	<u>1,559</u>

34. FINANCIAL COMMITMENTS

At 31 July 2006 there were annual commitments under non-cancellable operating leases as follows:

	Group	
	2006	2005
	£000	£000
Other:		
Expiring within one year	296	131
Expiring between two to five years inclusive	126	336
Expiring in over five years	-	3
	<u>422</u>	<u>470</u>

35. CONTINGENT LIABILITY

There are no material contingent liabilities.

36. RELATED PARTY TRANSACTIONS

The financial statements of the group include transactions with related parties. In accordance with FRS 8, these are reported where members of the Court disclose an interest in a body with which the group undertakes transactions which are deemed to be material.

The Interactive University is a global publishing and distribution company for the Scottish post compulsory education sector. It provides learning, technology and business services to enable Scottish educational institutions to deliver high quality educational programmes throughout the world.

Total sales to and purchases from Interactive University during the year were £937,000 (2005: £1,176,000) and £204,000 (2005: £246,000) respectively. At 31 July 2006 trade debtors included £330,000 (2005: £691,000) due by Interactive University to the Heriot-Watt University.

On the 8th May 2006 a loan agreement was signed by Heriot-Watt University with The Interactive University. As at 31st July 2006 the balance drawn down was £1,015,000 which is repayable in full by 30th November 2007 at a rate of 2% over the bank base rate.

NOTES TO THE ACCOUNTS – continued

37. ACCESS FUNDS

	Group		
	Childcare	Hardship	Total
	£000	£000	£000
At 1 August 2005	26	89	115
Funding Council grants	31	322	353
Disbursed to students	(31)	(334)	(365)
Repaid to funding body	(21)	(52)	(73)
Balance unspent at 31 July 2006	<u>5</u>	<u>25</u>	<u>30</u>
Repayable to funding body	<u>-</u>	<u>-</u>	<u>-</u>

Funding council grants are available solely for students; the group acts only as a paying agent. The grants and related disbursements are therefore excluded from the Income and Expenditure Account.

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Graduates	<i>David A Brew</i> ^{1,2} Moyra Kedslie ¹ Yvonne Savage ¹	<i>BA, MSc</i> BA, PhD, FCCA, FRSA BA
Students Association	<i>Niall Armstrong</i> ² Liam Burns ⁵ Steven Findlay	 BSc
Co-opted	Neil Fraser ¹ <i>Andrew Muirhead</i> ^{1,4} Dr Alan Parsley ¹ Ray Perman ¹ Ed Weeple ¹ David E Woods ¹	BA <i>FCIBS, MBA</i> BSc, PhD BA, MBA CB, MA MA MSc FIA

¹ Lay Member of Court² Member until 31st July 2006³ Member from 1st August 2006⁴ Member until 1st April 2006⁵ Member from 1st October 2006

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Professor J E L Simmons
Dr J Steel (from 1st October 2006)
Mr B Stewart
Professor G G Stewart *[until 30th September 2006]*
Professor A C Walker (from 1st August 2006)



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