

THE OPEN UNIVERSITY

FINANCIAL STATEMENTS
for the year ended 31 July 2006

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	Year Ended 31 July 2006 £million	Year Ended 31 July 2005 £million
RESULTS, CASH FLOWS, ASSETS AND RESERVES		
Funding council grants	201.1	182.7
Academic & other fees	115.6	115.5
Research grants and contracts	10.5	8.4
Other operating income	18.8	18.9
Interest receivable	6.7	7.7
TOTAL INCOME	352.7	333.2
SURPLUS FOR THE YEAR	9.4	4.7
Net cash (outflow)/inflow from operating activities	(1.4)	2.7
Net returns on investments and servicing of finance	2.9	5.3
NET CASH FLOW BEFORE INVESTING ACTIVITIES	1.5	8.0
Fixed assets	140.4	125.0
Net current assets	64.8	64.7
TOTAL ASSETS LESS CURRENT LIABILITIES	205.2	189.7
TOTAL RESERVES	94.5	85.1
OTHER KEY STATISTICS	Number	Number
Number of full-time equivalent students	72,843	74,052
Total number of students	217,985	202,943
Subject areas assessed for teaching quality	25	25
Subject areas deemed 'excellent' in teaching	18	18
Percentage of subject areas deemed 'excellent' in teaching	72%	72%

Teaching quality assessments were undertaken by the Quality Assurance Agency.

In August 2006 the second National Student Survey was published, in which The Open University was ranked top in respect of overall satisfaction by its students for the second time.

The Research Assessment Exercise carried out in 2001 assessed 26 units containing research active staff. Out of these, 4 units or 15% were graded 5 and 5* for research quality.

Scope of the Financial Statements

The financial statements comprise the consolidated results of the University and its trading subsidiary undertakings, together the 'Group'. The most significant of these subsidiaries are Open University Student Budget Accounts Limited (OUSBA) and Open University Worldwide Limited (OUW). The subsidiaries donate the bulk of their taxable profits to the University.

OUSBA provides credit facilities to students to enable them to pay fees due to the University. OUW undertakes activities that, for legal and commercial reasons, are most appropriately channelled through a limited liability company: these relate mainly to the commercial exploitation of the University's course materials and its rights therein throughout the world.

Operating Review

The Open University has a distinctive place in UK higher education. It promotes educational opportunity and social justice by providing high-quality university education to all who wish to realise their ambitions and fulfil their potential whatever their previous academic attainments. Through academic research, pedagogic innovation and collaborative partnership it seeks to be a world leader in the design, content and delivery of supported open and distance learning. The Open University is:

- open as to people – making university study available to an increasingly large and diverse student body and providing learning opportunities that meet individuals' lifelong needs;
- open as to places – providing learning opportunities in the home, workplace and community throughout the UK and selectively elsewhere, and serving an increasingly mobile population;
- open as to methods – using and developing the most effective media and technologies for learning, teaching and assessment whilst attaching central importance to the personal academic support given to students, and working collaboratively with others to extend and enrich lifelong learning;
- open as to ideas – developing a vibrant academic community that reflects and supports the diversity of intellectual interests of all students and staff and that is dedicated to the advancement and sharing of knowledge through research and scholarship.

The Open University is committed to creating a curriculum that is fully attuned to student needs and aspirations, that reaches out to new groups of potential learners who seek career and personal advancement and that enables them to achieve success. It strives to provide the best possible learning experience for students, and so it is particularly pleasing that in both the first and second ever National Student Surveys, The Open University was ranked top in respect of overall satisfaction by its students.

The Open University has no formal entrance requirements for admission to its undergraduate degree and diploma programmes. As students are not studying at a conventional university campus but are reliant on the resources available, or delivered to them, at home or their workplace, The Open University faces unique challenges in retaining students in study and helping them to progress to further courses. It owes its success in this regard to its Supported Open Learning methodology. It has been reported previously that over the past few years 18 out of the 25 subject areas assessed for teaching quality have been deemed excellent, a proportion bettered by few conventional universities.

The key statistics on page 2 show that student numbers grew by 15,042 or 7% to 217,985 this year; however, full-time equivalents fell by 1,209 or 2% to 72,843. Over the eight years since 1998, the increase in full-time equivalents was 4,756 or 7% and in individual students 52,696 or 32%. The faster growth in individual students reflects an increase in the proportion of students choosing to study shorter courses coupled with a significant increase in the number of students validated by the University. In terms of full-time equivalents, 35% of all part-time undergraduates in UK higher education institutions study with The Open University.

With effect from 1 August 2005 the responsibility for funding the University for teaching its students in Wales was transferred from the Higher Education Funding Council for England (HEFCE) to the Higher Education Funding Council for Wales (HEFCW). This transfer has not resulted in any significant changes in funding levels but will enable the University to respond better to specific initiatives of the Welsh Assembly and should increase its participation in the higher education sector in Wales.

Risk and Risk Management

In common with all UK universities, a significant proportion of income is dependent upon government policy, which is discussed in more detail in the section on future developments. The risks associated with this dependency, together with those associated with recruiting students in a competitive market and then delivering materials to those students and supporting them throughout their studies, are monitored and actively managed. A description of the key elements of the University's system of risk identification and management appears on page 17.

Results for the Year

The Group's results are summarised in the Financial Highlights on page 2.

Total income increased by £19 million or 6% to £353 million. The net result was a surplus for the year of £9.4 million compared to a surplus of £4.7 million last year.

Funding council grants increased by £18 million or 10% to £201 million. As a result of an additional grant for 2005/06 announced and paid after the year end, recurrent grants from HEFCE increased by £4.7 million or 3% despite the transfer of funding to HEFCW, which provided £7 million of funding in the first year. HEFCE specific grants almost doubled from £6 million to £11 million, due primarily to grants of £3.0 million towards works necessary to comply with the Disability Discrimination Act and £1.1 million for the University's four Centres for Excellence in Teaching and Learning, whilst the smaller specific grants from the Scottish Funding Council increased by 40%. Grants from other funding councils increased in line with inflation. Fee income remained static at £116 million, due to a combination of carefully targeted price increases being offset by changes in the subject mix of students and the reduction in full-time equivalents discussed above. Income from research grants and contracts increased by £2.1 million or 25% to £10.5 million; in this context it was pleasing to note the increase in income from Research Councils, which is subject to stiff competitive bidding. Other income remained static. Interest receivable reduced by £1.0 million or 13% due to a combination of lower interest rates and smaller cash balances as a result of the continued net capital expenditure not financed by new deferred capital grants.

Expenditure increased by £15 million or 5% to £343 million. Total staff costs increased by £12 million or 6% to £210 million. Average staff numbers increased by 271 to 11,287 which accounted for nearly 3% of the increase in staff costs with the balance due to the increase in salary scales. Other (non-pay) operating expenses, excluding depreciation and interest, increased by £1.6 million or 1% to £121.8 million. The University spent £3 million providing financial assistance to students in addition to the £4 million of funding councils' access funds and bursaries disbursed to eligible students.

Cash Flow

The Financial Highlights on page 2 show that the Group generated a net cash inflow of £1.5 million before investing activities, a decrease of £6.5 million from the previous year. The reduction was due mainly to a £9.2 million decrease in creditors, of which the largest single contributor was a reduction of £5.3 million in trade creditors.

Capital Projects

Additions to freehold land and buildings during the year totalled £22.6 million, of which £9.2 million was financed by new deferred capital grants. £14.6 million of the additions comprised the costs of refurbishing several buildings on the Walton Hall campus and extending one laboratory building. During the year the building housing the University's Manchester regional centre was offered on the market and, since its acquisition provided benefits in terms of flexibility and value for money, the University purchased it for £8 million.

Long-Term Borrowing Facility

The University has a fully drawn down 25 year long-term borrowing facility with Royal Bank of Scotland for £60 million to finance a significant proportion of its recent and current building programme. The facility is structured to provide maximum flexibility at minimum cost over its whole life, which is determined at the option of the University, and will be repaid in equal annual instalments from 2009. The facility is secured on a part of the University's Walton Hall campus in Milton Keynes.

Royal Bank of Scotland also provides a loan of £3 million to one of the University's subsidiaries on similar terms.

Financial Strategy

The University's financial strategy is designed to maintain sufficient financial flexibility at all times. It is expressed through three parameters:

- to maintain net current assets at a minimum of 30 days' expenditure;
- to at least balance normal recurring income with normal recurring expenditure, taking one year with another, over the medium term and to aim for a surplus of 2% of income;
- to restrict the maximum level of borrowings to the value of total fixed assets less deferred capital grants.

These parameters are considered in the development and implementation of the Group's treasury policy, its normal planning, budgeting and medium-term forecasting cycle, and in the planning and execution of its capital building programme.

The University's Finance Committee reviewed the financial strategy during the course of the year and the University's Council accepted the recommendation that it should continue unchanged.

Treasury Management

The financing and liquidity of the Group and its exposure to financial risk are managed through the central treasury function of the Finance Division. The Group's formal financial strategy, discussed above, sets minimum liquidity levels in order to ensure that sufficient financial flexibility is retained. Each year, as part of its normal planning processes, rolling five year financial forecasts are prepared: this process incorporates a review of capital expenditure and cash generation and so should enable any necessary future borrowing requirements to be negotiated well in advance of need.

The Group's foreign currency earnings form a very small proportion of total income and hence the overall exposure to exchange rate risk is small. It is therefore not appropriate to adopt particular strategies to reduce this risk, although this policy is kept under review.

The Group is potentially vulnerable to changing interest rates on its cash balances, which are all held in the form of interest bearing deposits with financial institutions. Interest income is however a small proportion of total income and borrowings represent only approximately half the value of total deposits and cash balances. The cornerstone of the Group's treasury policy remains the minimisation of risk: it limits and monitors the level of funds that may be placed in fixed rate deposits or invested in financial instruments that mature after one year and up to five years. Policies, incorporating clearly defined controls and reporting requirements, are in place to monitor credit and market risk, as well as to maintain the operating financial flexibility of the Group. Overall, the Group has low vulnerability to changing interest rates.

The University's Finance Committee reviewed the Group's treasury policy during the course of the year and the University's Council accepted the recommendation that it should remain unchanged.

Accounting Policies

The Group financial statements have been prepared in accordance with the Statement of Principal Accounting Policies set out on pages 20 to 23. In accordance with Financial Reporting Standard 18, *Accounting Policies*, the University's Finance Committee has reviewed the Group's accounting policies and considers them to be the most appropriate to the Group's operations.

Pensions

The University has only one defined benefit pension scheme available to its UK based staff, the national Universities Superannuation Scheme (USS).

The disclosures in Note 24 on pages 40 and 41 in respect of USS refer to the latest actuarial valuation as at 31 March 2005. The next valuation, as at 31 March 2008, will not be published until early 2009. However, the USS Report and Accounts for the year ended 31 March 2006, which was dated 27 July 2006, refers to subsequent reviews of the funding level by the trustee on the advice of its actuary. The remainder of this section is drawn from that document, which should be referred to for a full understanding of the position of the scheme.

"The last full actuarial valuation of the scheme was carried out as at 31 March 2005. This revealed that the assets of the scheme at the valuation date were 77% of the accrued liabilities based on projected pensionable salaries with a past service deficit of £6,568 million. The institutions' contribution was maintained at 14% of annual salary and the employees' contribution rate was maintained at 6.35% of pensionable salary.

"The results of the actuarial valuation were discussed at the meeting for representatives of USS institutions which was held in London on 1 December 2005. The full text of the actuary's report to the institutions' meeting has been published and copies were sent to all institutions in February 2006. It is also available on the USS Ltd website.

"The actuary examined the mortality experience of active members and pensioners and was comfortable with maintaining the existing assumptions for deaths pre and post retirement based on that experience. He also maintained the same allowance for ill-health retirements as was adopted for the 2002 valuation, based on experience since the last valuation.

"The result of the actuarial calculations is that the scheme has moved from having a past service surplus of assets over liabilities at 31 March 2002 of £162 million to a deficit of £6,568 million at 31 March 2005. There is a surplus of £56 million attributable to the supplementary section leaving a past service deficit of £6,624 million in the main section.

"The actuary also carried out valuations of the scheme at 31 March 2005 on different bases. At that date, the scheme was 126% funded using the MFR prescribed assumptions introduced by the Pensions Act 1995 and 110% funded in terms of the Pension Protection Fund regulations introduced by the Pensions Act 2004. Although not referred to in the valuation report, and not a requirement for USS, the actuary estimated that the funding level at 31 March 2005 using the FRS 17 formula was approximately 90%.

"As can be seen by the disparity between the MFR and PPF bases of valuation on the one hand and USS's own assumptions on the other hand, the USS assumptions have been and remain conservative. The scope for variation in the funding level is substantial, depending on the various economic circumstances that can arise. For example, increasing the valuation rate of interest by 1% would reduce the liabilities by approximately £4 billion and indeed the increase in the assets of the fund since 31 March 2005, referred to below, has considerably improved the position. The fund continues to enjoy a positive cashflow with the aggregate of contributions and investment income exceeding benefit payments and this is expected to continue for many years. USS is a long-term investor with long-term liabilities and addressing the deficit reported above does not necessitate precipitous short-term action.

“Nevertheless, the management committee recognises that there are a number of issues which it, and indeed the sector, needs to address in the coming months which impact on the funding of the scheme. The increase in the promotional salary scale already experienced, the implementation of the new pay spine and the move to a more competitive recruitment market in higher education with the potential for further salary increases arising from the introduction of increased student fees are important factors. Also, improving mortality, the introduction of the Pension Protection Fund levy and new statutory funding regulations all put pressure on the funding of the scheme and increase the likelihood of an increase in the contribution rate at some point in the near future. These are issues which the management committee will be considering and on which it will be consulting with employers during 2006.

“The actuary monitors movements in the funding level of the scheme on an ongoing basis and reports on this regularly to the USS committees and officers. The strong investment performance of the scheme has seen the funding level increase during the year and, as at 31 March 2006, the actuary estimated that the assets of the scheme had increased to approximately 89% of the liabilities. He also estimated that, on the FRS 17 basis, the scheme would be over 100% funded at that date.

“The new requirements for scheme funding (which will impact USS following the 2008 actuarial valuation) require an assessment of a scheme’s ‘technical provisions’ to be made. These are the amount of assets judged sufficient to provide accrued liabilities with the assessment being based on ‘prudent’ assumptions. If there is a shortfall on this measure then additional contributions have to be paid to clear this shortfall. The basis that USS might adopt for setting the assumptions for this purpose have not yet been determined but will ultimately have to be agreed by the trustee company acting on the advice of the actuary. However, the actuary advised that as at 31 March 2005 the scheme was likely to have been more than fully funded on a technical provisions basis.”

Creditor Payment Policy

It is the Group’s policy to abide by terms of payment agreed with suppliers. Unless special terms apply, payment is made within 30 days of receipt of a valid invoice or after acceptance of the goods or services, whichever is the later.

Diversity and the Employment of Disabled Persons

One of the University’s current strategic priorities is to diversify and develop its staff base. Employee recruitment and grading processes, together with programmes for employee involvement, communication and training are all designed to promote equal opportunity to all irrespective of sex, race, religion, colour or sexual orientation.

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. If existing employees become disabled, every effort is made to continue their employment with the University and arrange appropriate training. It is the University’s policy that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

Employee Involvement and Training

The University places considerable value on the involvement of its employees and on good communication with them. Staff are informed through regular meetings, the extensive University intranet, open fora, staff newsletters, staff magazines and other means. Staff are encouraged to participate in formal and informal consultation at University and Unit level, through membership of formal Committees and informal working groups. The University has an Organisational Development and Change Unit that is responsible for providing technical and general training to all levels of staff and to help build leadership capacity.

Future Developments

The Higher Education Act 2004 has allowed universities in England and Wales to charge higher tuition fees for full-time students entering higher education from 2006. Students are eligible for additional loans that are subsidised from public funds through being repayable on an income contingent basis at a nil real rate of interest and written off after 25 years if not repaid in full by then. It is estimated that this will bring an additional £1 billion per annum to universities in England and Wales teaching full-time students by the time the full impact is felt in 2009. Part-time students are not eligible under the Act for similar levels of public subsidy but, since the University's tuition fees are currently less than half of the maximum equivalent full-time fee and its students do not have to pay for additional residential accommodation whilst studying, the divergence in market offerings and financial support is increasing, which should create opportunities for the University to exploit in future years. What is clear, though, is that the UK higher education market is going through a period of significant change.

In late 2005 there were two pieces of good news for the part-time higher education sector in general and The Open University in particular. The first announcement was that the funding for statutory fee support for the poorest part-time students would increase by more than a quarter in 2006, coupled with a quadrupling of the Access to Learning Fund allocation for part-time students from £3 million to £12 million from 2006. Universities are able to use the latter resource either as an additional fee support on top of the statutory fee support or to increase help to students facing financial hardship. The total allocation in respect of Open University students in 2006/07 will be £6 million. The second announcement was that HEFCE had decided to allocate an additional £40 million for 2006/07 and 2007/08 to ensure that students from disadvantaged backgrounds are not deterred from studying part-time. This additional funding forms part of HEFCE's overall widening participation funding and has been allocated through the element of existing formulae for part-time students that relates to outreach and access. The purpose of the widening participation funding is to recognise the additional costs of recruiting and supporting students from under-represented groups. As a result of this additional funding The Open University's HEFCE grant for widening participation has increased from £17 million in 2005/06 to £29 million in 2006/07.

The UK higher education sector suffered from industrial action by academic staff during the period from March to July 2006. As with all providers, The Open University took steps to minimise the impact on its students. In July a three year pay deal was accepted by all the trade unions in this sector, which will give certainty over pay rates for 2006/07 and 2007/08. The deal for 2008/09 is based on the Retail Prices Index, with a minimum award of 2.5%; however, it is subject to the outcome of a review of the sector's finances, which will also impact on subsequent years' pay awards.

Against the uncertainties discussed above are balanced the University's considerable strengths. It is the leader in the UK part-time higher education market and is the only university that can operate at scale throughout the UK, thus having the capability of fulfilling a national role. With its open access policy, it promotes fair access for all who want to study higher education courses and so has a substantial and unique contribution to make to widening participation in the UK. The Open University has earned a world-wide reputation for the quality of its teaching, where it is rated amongst the best in the UK, for the excellence of its materials and for its approach to supported open learning, which uses methods and technologies that are appropriate to the students and their learning needs. This has been confirmed by the University's top place for its students' overall satisfaction in the National Student Survey for two years in succession.

Through vigorous communication of these strengths to potential students, as part of general marketing campaigns and as part of targeted approaches to particular groups, the University expects to increase student numbers from the level in 2005/06. This work will be supplemented by continuing efforts to help students complete their courses of study and progress to further study with the University.

Within the UK as a whole, the University is responding to key trends: the growth of work-related higher education, greater emphasis on linking education to employability, and the demand for continuing professional development and lifelong learning. It is also monitoring the spread of new technologies and the scope they provide for pedagogic innovation to the benefit of students. Some of the University's courses are already delivered wholly on-line and its current learning and teaching strategy aims to ensure that all courses will have an on-line component by the end of 2007.

Within the same timescale, all administrative services will be made available on-line, thus enabling paper documents to be withdrawn and so improving efficiency and reducing costs. Over 200,000 students and customers already access many services on-line and, from December 2006, all of the University's associate lecturers will be able to interact on-line. The University has commenced development of a virtual learning environment for phased implementation over the next two years, which will provide a consistent and enhanced learning experience for students.

On 25 October 2006, the University launched OpenLearn, a major new open content initiative to make a selection of learning materials and on-line learning tools available to learners and educators free of charge on the internet under a Creative Commons licence. The philosophy of open content is entirely commensurate with the University's founding principles of widening access to high quality educational opportunities. With its innovative use of both a LearningSpace and a LabSpace, the University expects to make a very significant contribution to the global expansion of the open educational resources movement and to the development of both the quality and reach of such resources delivery at an international level. At the same time, this initiative will provide an important learning platform for the University as it develops its strategic direction and new business models for the future.

In February 2006, the University secured a grant of US\$4.5 million (£2.5 million) from The William and Flora Hewlett Foundation towards OpenLearn's estimated £5.7 million costs; the University is planning to apply for a similar sum from the Foundation in 2007. The initiative is being undertaken as a two-year pilot, during which time the University will explore both its technical and business impact, as well as the longer-term sustainability issues.

On the international front, the University has maintained its direct teaching activities in Europe and its partnership activities in Eastern Europe and the rest of the world. Through these activities some 45,000 students across 30 countries benefit from the University's materials and pedagogy. At the same time the University has boosted its involvement in teaching in Africa and Asia by working with a variety of public and private organisations.

The aim of the University's research strategy is to focus both research support and effort more tightly around themes of excellence in order to increase the University's research standing as well as improve its ability to attract external funding. This is particularly important at a time when the funding of research in UK universities is under review and so subject to some uncertainty, and in the lead up to the national Research Assessment Exercise in 2008. The introduction of full economic costing from 2005 as the basis for funding projects by Research Councils and government departments should improve the infrastructure support for research across the sector, although the full benefit will not be felt until 2009. Opportunities are being developed for partnering with commercial organisations, national charities and other universities in order to secure new routes for the development, dissemination and exploitation of the University's research base and its associated enterprise agenda. In this regard it was very pleasing that HEFCE allocated the University £2 million over the two years 2006 to 2008 under its Higher Education Innovation Fund.

Conclusion

Through prudent financial management and systematic review of strategy, values and processes, the University continues to operate effectively in a challenging environment and can confront a period of significant change in the higher education market with confidence. It has re-affirmed its strong commitment to widening participation and to delivering high quality services, receiving additional funding for the former and national recognition for the latter. The University's record of continuous improvement and innovation in relation to student support, learning, teaching, assessment, curriculum and research should assure its unique position in the higher education sector.

R DELBRIDGE
Treasurer

M S HEDGES
Finance Director

B M GOURLEY
Vice-Chancellor

6 December 2006

Corporate Governance and Accountability Arrangements

The Open University is a body incorporated by Royal Charter. Although the University does not have shareholders and is not a listed company, the University's Council is committed to achieving high standards of corporate governance, in line with accepted best practice. Accordingly, the University's Council believes it is appropriate to report on compliance, as far as is practicable, with the appropriate provisions of the Combined Code issued by the Financial Reporting Council on 23 July 2003.

Throughout the year ended 31 July 2006, the University has been in compliance with all the Code provisions set out in the Combined Code insofar as they relate to universities.

In November 2004 the Committee of University Chairmen issued a Guide for Members of Higher Education Governing Bodies in the UK which incorporates a Governance Code of Practice. This code is voluntary and is intended to reflect good practice in a sector which comprises a large number of very diverse institutions. Institutions should state that they have had regard to the code, and where an institution's practices are not consistent with particular provisions of this code, an explanation should be published in the corporate governance statement of the annual audited financial statements.

In respect of the year ended 31 July 2006, the University's Council can report that the only element of this Code with which the University's practice was not consistent was in relation to the size of the Council, 35 compared to the recommended 25. However, in 2004 a review of the University's governance arrangements was undertaken and, with Privy Council agreement, Council agreed that its size should be reduced to 25 with effect from 1 August 2006. This has now been implemented.

The University Council

The University's Council comprises ex-officio and co-opted external members, students, ex-officio employees and employees appointed under the Statutes of the University, the majority of whom are non-executive. The roles of Chairman and Vice-Chairman of the Council are separated from the role of the University's Chief Executive, the Vice-Chancellor.

The University's Council has adopted a statement of primary responsibilities, which is published in the University's freedom of information website. This statement sets out the Council's responsibilities in respect of the proper conduct of public business, strategic planning, monitoring effectiveness and performance, finance, audit, estate management, human resources management, equality and diversity, students' union, health and safety, and the appointment of the University's officers.

The statement of Responsibilities of the University's Council on pages 16 and 17 describes its responsibilities in respect of maintaining accounting records, preparing financial statements and accountability arrangements. It also summarises the University's system of internal control and its system of risk identification and management.

The Council has the following committees: a Strategic Planning and Resources Committee, a Finance Committee, a Membership Committee, a Remuneration Committee, a Staff Strategy Committee, an Estates Committee, and an Audit Committee. All of these committees are formally constituted with terms of reference. With the exception of the Strategic Planning and Resources Committee, the Chairman of each Committee is a lay Council member. All members of Council who sit on the committees and other co-opted members of the committees are appointed by the Council on the recommendation of the Membership Committee. The corporate governance disclosures in respect of these committees follow those in respect of Council itself.

The Council met five times during the year. The members of the University's Council during the year ended 31 July 2006, and their attendance at the meetings held during their membership, were:

THE OPEN UNIVERSITY

CORPORATE GOVERNANCE STATEMENT (continued)

Ex-officio members who are also officers of the University:

Pro Chancellor & Chairman of Council	Lord Haskins (5/5)
Treasurer	Mr R Delbridge (4/5)
Vice-Chancellor (Employee)	Professor B M Gourley (5/5)
Pro-Vice-Chancellors (Employees)	Dr P M Clark (3/5) Professor B R Heywood (5/5) Professor L J C Jones (5/5) Professor D M Vincent (4/5)

Ex officio members:

President, OU Students Association	Ms J Jones to March 2006 (3/3) Ms R Rosenthal from March 2006 (2/2)
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Elected members:

Members of Senate (Employees)	Professor S Segal-Horn (4/5) Ms P Graham to September 2005 (1/1) Dr S M Payne (4/5) Mr P W Syme (5/5)
Associate Lecturers (Employees)	Dr M Hopkins (4/5) Ms E Rankin (5/5)
OU Students Association	Mr G Macfarlane (5/5)
Non-academic Staff (Employees)	Mr D Warburton (4/5)
Academic Related Staff (Employees)	Mrs K Signorini (4/5)

External members co-opted by Council:

Mr S Barnett (5/5)	Ms C McEwen (5/5)
Dr S Blackburn (0/5)	Professor A Miller (2/5)
Mrs C Ighodaro (4/5)	Mr A Peck (5/5)
Mr R J Chenery (4/5)	Mr S Thornton (3/5)
Mr R Dawe – Vice-Chairman (5/5)	Mr A Tuckett (4/5)
Mr S Etherington (1/5)	Ms A Watts (5/5)
Mr R Lewis (1/5)	Ms A Dixon-Barrow (0/5)
Dr A G Limb (5/5)	Mr P Mantle (4/5)
Mr H G O'Brien (4/5)	Dr M Meade from October 2005 (3/4) Professor L Wagner (4/5)

Officers in attendance at Council meetings:

University Secretary: Mr A F Woodburn
Finance Director: Mr M S Hedges
Director, Students: Mr W S Swann

Strategic Planning and Resources Committee

In respect of its strategic and development responsibilities, the Council receives recommendations and advice from the Strategic Planning and Resources Committee, a joint committee of the Council and of the Senate, the body responsible for the University's academic affairs. It recommends to Council the distribution of resources within the University on the basis of its strategic direction and requirements.

The Strategic Planning and Resources Committee met twice during the year. The members during the year ended 31 July 2006, and their attendance at the meetings held during their membership, were:

External members of Council	Lord Haskins (2/2) Mr R Dawe (2/2) Mr R Delbridge (2/2) Dr A Limb (2/2) Ms C McEwen (0/2)
<i>Employees</i>	Professor B M Gourley – Vice-Chancellor, Chair (2/2) Professor B R Heywood – Pro-Vice-Chancellor (2/2) Professor D A Brannan – Dean (2/2) Dr P M Clark – Pro-Vice-Chancellor (2/2) Mr M S Hedges – Finance Director (non-voting) (2/2) Mr G Lammie – Senate elected member (2/2) Professor L J C Jones - Pro-Vice-Chancellor (2/2) Professor R E Moon – Senate elected member (2/2) Dr P J Sarre – Senate elected member (2/2) Mr W S Swann – Director Students (2/2) Professor D M Vincent – Pro-Vice-Chancellor, Deputy Chair (2/2) Mr M A Watkinson – Head of Planning (non-voting) (2/2) Mr A F Woodburn – University Secretary (2/2)

Membership Committee

The Membership Committee brings forward recommendations for the appointment or re-appointment of co-opted members of the Council, including recommendations on periods of office. It also makes recommendations to the Council for the appointment of Council members to committees of the Council and committees of the University to which Council members are appointed. Its recommendations to Council take into account the balance of skills, knowledge and experience of Council members and are based on assessment against objective criteria. It also considers issues of succession planning within the Council. It provides the Council with an annual review of attendance at meetings of the Council and its committees.

The Membership Committee met four times during the year. The members during the year ended 31 July 2006, and their attendance at the meetings held during their membership, were:

External members of Council	Lord Haskins - Chair (4/4) Mr S Barnett (3/4) Ms A Dixon-Barrow (0/4) Mr S Etherington (1/4)
Employees	Professor B M Gourley – Vice-Chancellor (4/4) Ms E Rankin (4/4) Professor S Segal-Horn (0/4) Mr P W Syme (4/4)

Finance Committee

The Finance Committee reviews and then recommends to Council the University's annual revenue and capital budgets and monitors performance in relation to the approved budgets. It reviews and then recommends to Council the financial regulations and financial policies that are applied by management. It reviews the annual financial statements, including significant matters of judgement arising that require review, and meets with the external auditors to discuss the outcome of their audit; it then recommends the financial statements to Council for approval.

The Finance Committee met five times during the year. The members during the year ended 31 July 2006 (of whom the Chair and two others have recent and relevant financial experience), and their attendance at the meetings during their membership, were:

<i>External members of Council</i>	Mr R Delbridge – Chair (5/5) Lord Haskins (5/5) Mr R Lewis (0/5) Mr H G O'Brien (4/5) Mr S Thornton (1/5)
<i>Other external member</i>	Mr J Tasker (4/5)
<i>Employee</i>	Professor B M Gourley – Vice-Chancellor (4/5)
<i>Officers in attendance</i>	Mr M S Hedges – Finance Director Professor D M Vincent – Pro-Vice-Chancellor Mr A F Woodburn – University Secretary

Remuneration Committee

The Remuneration Committee determines the annual remuneration of the most senior staff, including the Vice-Chancellor. The cost of living salary increases for all staff are determined by national pay negotiations for all universities. The employee members have no involvement in determining their own salaries.

External members of Council receive no remuneration for their services although expenses incurred in attending meetings are met by the University. Members of Council who are employees of the University receive no additional remuneration for their services to Council although, once again, expenses incurred in attending meetings are met by the University.

The Remuneration Committee met once during the year. The members during the year ended 31 July 2006, and their attendance at the meetings held during their membership, were:

<i>External members of Council</i>	Lord Haskins - Chair (1/1) Mr S Barnett (1/1) Mr R Dawe (1/1) Mr R Delbridge (1/1)
<i>Employee</i>	Professor B M Gourley – Vice-Chancellor (1/1)

Staff Strategy Committee

The Staff Strategy Committee advises the Council, subject to the powers of the Senate in respect of academic staff, on the development and approval of policies and strategies concerning the University's full and part-time staff. In fulfilling this role, it authorises the implementation of such policies and strategies and monitors these through University bodies or individuals.

The Staff Strategy Committee met three times during the year. The members during the year ended 31 July 2006, and their attendance at the meetings held during their membership, were:

<i>External members of Council</i>	Mr S Barnett – Chair (3/3) Lord Haskins from January 2006 (0/2) Mr A Peck (3/3) Ms A Watts (3/3)
<i>Employees</i>	Mr A Burrell (3/3) Professor B M Gourley – Vice-Chancellor (0/2) Professor B R Heywood - Pro-Vice-Chancellor (3/3) Professor A B Lane (2/3) Dr C K Lloyd (3/3) Mr A F Woodburn – University Secretary (3/3)

Estates Committee

The Estates Committee develops the University's estates strategy for recommendation to Council. It recommends the rolling capital programme and monitors progress and expenditure thereon.

The Estates Committee met three times during the year. The members during the year ended 31 July 2006, and their attendance at meetings during their membership, were:

<i>External member of Council</i>	Mr P Mantle – Chair (3/3)
<i>Other external members</i>	Mr R Booker (3/3) Mr R J Chenery (3/3)
<i>Employees</i>	Professor D Brannan to March 2006 (0/1) Professor J Fleck from March 2006 (1/2) Mr M S Hedges – Finance Director (3/3) Professor B R Heywood – Pro-Vice-Chancellor (0/3) Ms A Howells (for Mr Rosenbloom) (1/2) Dr R J Matela (3/3) Mr B Palmer (3/3) Mr I Rosenbloom (1/1) Mrs N Whitsed (2/3) Mr A F Woodburn – University Secretary (3/3)

Audit Committee

The Audit Committee comprises wholly external members, drawn from both within and outwith the Council, and so has no executive responsibility. During the year ended 31 July 2006 the Audit Committee met three times. Its members (of whom the Chair and two others have recent and relevant financial experience), and their attendance at meetings held during their membership, were:

<i>External members of Council</i>	Mrs C Ighodaro – Chair (3/3) Dr S Blackburn (1/3) Mr A Peck (3/3)
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<i>Other external member</i>	Mr G Wilkinson (3/3)
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The Audit Committee relies substantially on the work of the internal and external auditors, on the information provided by management and on the response of management to the questions it raises.

The remit of Audit Committee includes:

- reviewing the effectiveness of the Group's arrangements for risk management, control, and governance;
- satisfying itself and assuring Council, with advice from the Chief Auditor, that satisfactory arrangements are in place to promote economy, efficiency and effectiveness;
- reviewing and approving the terms of reference of the internal audit function and monitoring its performance and effectiveness;
- advising the Council, as necessary, on the appointment and remuneration of the external auditors, and monitoring their performance and effectiveness;
- reviewing with the external auditors the scope and nature of the audit, including the report to Audit Committee written by the external auditors;
- assessing compliance with the regulatory framework relating to audit issues.

The external auditors have a standing arrangement to meet the Audit Committee members regularly without staff present. The auditors also attend meetings with staff to consider the items listed above and to review plans for the audit process.

The University's internal audit function is responsible for providing an objective and independent appraisal and assurance on all the University's activities, financial and otherwise. In particular, assurance on the arrangements for risk management, control, governance and value for money is delivered to the Council and the Vice-Chancellor, through the Audit Committee. All reviews undertaken by internal audit are considered with the management in the relevant operational unit. The reviews are also considered by the Vice-Chancellor, University Secretary and Finance Director and appropriate action confirmed to the Audit Committee. The Chief Auditor has unfettered access to the Audit Committee.

The internal audit work programme is drawn down from a risk-focused audit plan, which remains dynamic and is updated regularly to reflect changes in the University's risk profile. Internal audit monitors the progress made by units in implementing recommendations to ensure that they are addressed in a timely and effective manner, and reports regularly thereon to the Audit Committee.

The Audit Committee also keeps under review the independence and objectivity of the external auditors. The committee reviews the nature and amount of non-audit work undertaken by PricewaterhouseCoopers LLP each year to satisfy itself that there is no effect on their independence. In some cases the nature of the advice may make it more timely and cost effective to select PricewaterhouseCoopers LLP, who already have a good understanding of the University. PricewaterhouseCoopers LLP may also be appointed for consultancy work but only after rigorous checks to confirm they are the best provider, including competitive tender. PricewaterhouseCoopers LLP are also subject to professional standards which safeguard the integrity of the auditing role they perform on behalf of the University.

THE OPEN UNIVERSITY

RESPONSIBILITIES OF THE UNIVERSITY'S COUNCIL

In accordance with the University's Charter and Statutes, the Council is responsible for the administration and management of the University's affairs and is required to present audited financial statements for each financial year.

The Council is responsible for ensuring that proper accounting records are kept that disclose with reasonable accuracy at any time the financial position of the University and enable the financial statements to be prepared in accordance with the University's Charter and Statutes, the Statement of Recommended Practice on Accounting for Further and Higher Education Institutions and other relevant accounting standards. In addition, within the terms and conditions of the Financial Memorandum between the Higher Education Funding Council for England (HEFCE) and the University's Council and the HEFCE Accounts Direction, the Council, through its designated office holder, is required to prepare financial statements for each financial year that give a true and fair view of the University's state of affairs and the surplus or deficit and cash flows for that year.

In causing the financial statements to be prepared, the Council has ensured that:

- 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 financial statements;
- financial statements are prepared on the going concern basis unless it is inappropriate to presume that the University will continue in operation. The Council is satisfied that it has adequate resources to continue in operation for the foreseeable future: for this reason the going concern basis continues to be adopted in the preparation of the financial statements.

The Council has taken reasonable steps to:

- ensure that funds from HEFCE, the Scottish Funding Council (SFC), the Higher Education Funding Council for Wales (HEFCW) and the Training and Development Agency for Schools (TDA) are used only for the purposes for which they have been given and in accordance with the Financial Memorandum with HEFCE and the Funding Agreements with SFC, HEFCW and TDA and any other conditions which the Funding Councils or Agency may from time to time prescribe;
- ensure that there are appropriate financial and management controls in place to safeguard public funds and funds from other sources;
- ensure that there are effective systems of risk identification and management that cover all risks, produce a balanced portfolio of risk exposure, are based on a clearly articulated policy and approach, are monitored and reviewed regularly, are integrated into normal business processes and aligned to the University's strategic objectives and are managed by heads of units and senior managers;
- 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.

THE OPEN UNIVERSITY

RESPONSIBILITIES OF THE UNIVERSITY'S COUNCIL (continued)

The key elements of the University's system of internal control, which is designed to discharge the responsibilities set out above, include the following:

- definitions of the responsibilities of, and the authority delegated to, heads of academic and administrative units;
- a medium and short-term planning process, supplemented by detailed annual income, expenditure, capital and cash flow budgets;
- regular reviews of academic performance and quarterly financial reviews involving variance reporting and updates of forecast outturns;
- defined and formalised requirements for approval and control of expenditure, with investment decisions involving capital or revenue expenditure being subject to formal detailed appraisal and review according to approval levels set by Council;
- Financial Regulations, including financial controls and procedures, approved by Finance Committee;
- a professional Internal Audit team whose annual programme is approved by Audit Committee.

The key elements of the University's system of risk identification and management, which is designed to discharge the responsibilities set out above, include the following:

- linking the identification and management of risk to the achievement of institutional objectives through the annual planning process;
- evaluating the likelihood and impact of risks becoming a reality as part of that same process and establishing mitigating controls;
- having review procedures that cover business, operational, compliance and financial risk;
- embedding risk assessment and internal control processes in the ongoing operations of all units;
- reporting regularly to Audit Committee, and thence to Council, on internal control and risk;
- reporting annually to Council the principal results of risk identification, evaluation and management review.

Any system of internal control or risk management is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, but not absolute, assurance against material misstatement or loss.

In relation to the University's financial statements published on its website, the University's management is responsible to Council for the maintenance and integrity of The Open University website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

We have audited the financial statements on pages 20 to 41, which comprise the Consolidated Income and Expenditure Account, the Balance Sheet, the Consolidated Cash Flow Statement and the related Notes to the Accounts, which have been prepared under the historical cost convention (as modified by the revaluation of certain fixed assets) and in accordance with the accounting policies set out in the Statement of Accounting Policies on pages 20 to 23.

Respective Responsibilities of the University's Council and Auditors

As described in the Statement of Responsibilities of the University's Council on pages 16 and 17, the University's Council is responsible for preparing the financial statements in accordance with the Accounts Direction issued by the Higher Education Funding Council for England, the Statement of Recommended Practice on Accounting for Further and Higher Education Institutions and applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

Our responsibility is to audit the financial statements in accordance with the relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Council of The Open University in accordance with the Charter and Statutes of the University. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

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 on Accounting for Further and Higher Education Institutions. We also report to you whether, in our opinion, income from funding bodies, grants and income for specific purposes and from other restricted funds administered by the University have been properly applied in all material respects for the purposes for which they were received and whether income has been applied in all material respects in accordance with the University's Charter and Statutes and, where appropriate, with the Financial Memorandum with the Higher Education Funding Council for England and with the Funding Agreements with the Scottish Funding Council, the Higher Education Funding Council for Wales and the Training and Development Agency for Schools. We also report to you if, in our opinion, the University has not kept proper accounting records, the accounting records do not agree with the financial statements or if we have not received all the information and explanations we require for our audit.

We read the other information contained in the financial statements and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the Financial Highlights, the Operating and Financial Review, the Corporate Governance Statement and the Statement of the Responsibilities of the University's Council.

We also review the statement of internal control contained within the Statement of the Responsibilities of the University's Council and comment if the statement is inconsistent with our knowledge of the University. We are not required to consider whether the statement of internal control covers all risks and controls, or to form an opinion on the effectiveness of the University's corporate governance procedures or its risk and control procedures. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of Opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Audit Code of Practice issued by the Higher Education Funding Council for England. 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's Council in the preparation of the financial statements and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations that 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 by error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- a. the financial statements give a true and fair view of the state of affairs of the University and the Group at 31 July 2006 and of the surplus of income over expenditure and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Statement of Recommended Practice *Accounting for Further and Higher Education Institutions*;
- b. in all material respects, income from the Higher Education Funding Council for England, the Scottish Funding Council, the Higher Education Funding Council for Wales and the Training and Development Agency for Schools, grants and income for specific purposes and from other restricted funds administered by the University have been applied only for the purposes for which they were received;
- c. in all material respects, income has been applied in accordance with the University's Charter and Statutes and, where appropriate, with the Financial Memorandum dated December 2003 with the Higher Education Funding Council for England, with the Funding Agreement dated July 2000 with the Scottish Funding Council, with the Funding Letter dated April 2006 with the Higher Education Funding Council for Wales and with the Funding Agreement dated November 1997 with the Training and Development Agency for Schools.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
Milton Keynes

6 December 2006

1 Basis of preparation

The financial statements have been prepared under the historical cost convention as modified by the revaluation of land and buildings, in accordance with the Statement of Recommended Practice, *Accounting for Further and Higher Education Institutions*, and in accordance with applicable Accounting Standards.

2 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the University and its subsidiary undertakings for the financial year to 31 July.

The consolidated financial statements do not include those of the Open University Students Association, as the University has no control or significant influence over policy decisions.

3 Recognition of income

- a. Fee income is credited to the income and expenditure account over the period in which the students are studying. This is achieved by using a time apportionment basis over the period of the relevant course.

Fee income is stated gross; financial assistance to students, other fee waivers and provision for bad debts are included in other operating expenses.

Where students have registered, which is when the liability to pay the fees is created, for courses that begin in a future financial year, the income is included in creditors as income in advance. Where these fees have not been paid wholly or partly in advance by the end of the financial year in which registration takes place or if payment will become due in a future financial year under an instalment credit agreement, the amount not received at the end of the financial year is included in debtors.

- b. Recurrent grants from Funding Councils are accounted for in the University's financial statements in the period to which they relate.
- c. Non-recurrent grants received in respect of the acquisition or construction of fixed assets are treated as deferred capital grants and amortised in line with depreciation over the life of the assets.
- d. Income for specific purposes, such purposes being designated by the grant-making body or donor under a specific agreement or contract, and which can only be applied for those specific purposes, is credited to the income and expenditure account over the life of the agreement or contract when the conditions attaching to its receipt have been met, such as incurring the appropriate expenditure, including expenditure on indirect costs.
- e. Income from the sale of goods or services is credited to the income and expenditure account when the goods or services are supplied to the external customers against the orders received or the terms of the contract have been satisfied.
- f. Interest receivable is credited to the income and expenditure account on a daily basis.

4 Recognition of expenditure

- a. Expenditure is recognised in respect of goods and services received when supplied in accordance with contractual terms.
- b. Provision is made when an obligation exists for a future liability in respect of a past event and where the amount of the obligation can be reliably estimated.
- c. Restructuring costs are recognised in respect of the direct expenditure of a reorganisation where plans are sufficiently detailed and well advanced, and where appropriate communication to those affected has been undertaken at the balance sheet date.
- d. Course development costs are charged to the income and expenditure account as they are incurred.
- e. The University has a maintenance plan designed to keep its estate in a constant state of good repair. The cost of maintenance is charged to the income and expenditure account in the period in which it is incurred.
- f. Loan interest is charged to the income and expenditure account on a daily basis.

5 Foreign currencies

Transactions denominated in foreign currencies are recorded at the rate of exchange ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into sterling either at year end rates or, where there are related forward foreign exchange contracts, at contract rates. The resulting exchange differences are dealt with in the determination of income and expenditure for the financial year.

6 Pension schemes

In the United Kingdom the University participates in two schemes to provide retirement and death benefits for its employees, namely, the Universities Superannuation Scheme (USS) and the Federated Superannuation System of Universities (FSSU). In the Republic of Ireland a small number of employees are members of the defined contribution Open University Retirement Solution Plan (OURSP). A small number of overseas based employees are members of defined contribution schemes.

a. Defined benefit scheme (USS)

The assets of the scheme are held in a separate trustee-administered fund. The University is unable to identify its share of the underlying assets and liabilities in USS on a reasonable and consistent basis and therefore, as required by Financial Reporting Standard 17 Retirement Benefits, the University accounts as if USS were a defined contribution scheme. As a result the amount charged to the Income and Expenditure Account represents the contributions payable to USS in respect of the accounting period.

b. Defined contribution schemes (FSSU, OURSP and others)

The amount charged to the Income and Expenditure Account represents the contributions payable to the scheme in respect of the accounting period.

7 Leasing costs

Rental costs under operating leases are charged to expenditure in equal annual amounts over the period of the lease.

8 Stocks of finished goods

- a. Stocks of course materials are valued at the lower of cost and net realisable value. Provision is made for obsolete or surplus course materials.
- b. Stocks of materials for use at residential schools are written off when purchased.

9 Investments

- a. Investments in subsidiaries are shown at cost.
- b. Current asset investments comprise funds held on deposit. Interest is accrued on a daily basis.

10 Land and buildings

Land and buildings held at 31 July 1998 are shown in the balance sheet at the valuation on that date; land and buildings acquired after 31 July 1998 are shown at cost. The revaluation at 31 July 1998 was undertaken in accordance with the appraisal and valuation manual prepared by the Royal Institution of Chartered Surveyors. The Walton Hall campus was valued on the basis of depreciated replacement cost and all other buildings on the basis of existing use value. The valuation was conducted by Chesterton plc, International Property Consultants.

On adoption of Financial Reporting Standard 15, *Tangible Fixed Assets*, the Group adopted the transitional provisions to retain the book value of land and buildings, many of which were last revalued in 1998, and has not adopted a policy of annual revaluations for the future. However, these values are subject to impairment reviews as set out in Financial Reporting Standard 11, *Impairment of Fixed Assets and Goodwill*.

Freehold land is not depreciated as it is considered to have an indefinite useful life. Buildings are depreciated over their expected useful lives of 40 years. Where buildings have a major refurbishment to adapt them for another use or extend their original useful life, the refurbishment cost is depreciated over their revised expected useful lives, which is a maximum of 40 years from date of the adaptation. Minor refurbishments to buildings are depreciated over the remaining expected useful lives of the buildings, with a maximum period of 10 years.

Where buildings are acquired with the aid of specific grants, they are capitalised and depreciated as above. The related grants are treated as deferred capital grants and released to income over the expected useful life of the buildings.

11 Equipment

Equipment, including computers and software, costing less than £30,000 per individual item or group of related items is written off in the year of acquisition. All other equipment is capitalised.

Capitalised equipment is stated at cost and depreciated over its expected useful life as follows:

Telephone equipment	5 years
Motor vehicles	4 years
Computing equipment	3 years
Other equipment	3 years

Where equipment is acquired with the aid of specific grants, it is capitalised and depreciated as above. The related grants are treated as deferred capital grants and released to income over the expected useful life of the equipment, which is the period of the grant in respect of equipment acquired for specific research projects.

12 Taxation status

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 Taxes Act 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 Taxes Act 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 University receives no similar exemption in respect of Value Added Tax.

CONSOLIDATED INCOME AND EXPENDITURE ACCOUNT for the Year Ended 31 July 2006

	NOTES	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
INCOME			
Funding council grants	1	201.1	182.7
Academic & other fees	2	115.6	115.5
Research grants and contracts	3	10.5	8.4
Other operating income	4	18.8	18.9
Interest receivable	5	6.7	7.7
Total income		352.7	333.2
EXPENDITURE			
Staff costs	6	209.8	198.0
Depreciation		8.5	6.8
Other operating expenses	7	121.8	120.2
Interest payable	8	3.1	3.5
Total expenditure		343.2	328.5
Surplus after depreciation of assets at valuation and before tax		9.5	4.7
Less: Taxation	9	0.1	0.0
Surplus after tax		9.4	4.7
NOTE OF HISTORICAL COST SURPLUS			
Surplus after depreciation of assets at valuation and tax		9.4	4.7
Difference between an historical cost depreciation charge and the actual depreciation charge for the year	17	1.1	1.2
Historical cost surplus after tax		10.5	5.9

The income and expenditure account has been prepared on an historical basis as modified by the revaluation of land and buildings and is solely in respect of continuing activities.

The surplus after tax represents the total recognised gains for the year; accordingly, no separate statement of total recognised gains and losses has been prepared.

The accounting policies on pages 20 to 23 and the notes on pages 27 to 41 form an integral part of these financial statements.

THE OPEN UNIVERSITY

BALANCE SHEET as at 31 July 2006

	NOTES	CONSOLIDATED		UNIVERSITY	
		As At 31 July 2006 £m	As At 31 July 2005 £m	As At 31 July 2006 £m	As At 31 July 2005 £m
FIXED ASSETS					
Tangible assets	10	140.4	125.0	129.9	114.2
Investments	11	0.0	0.0	10.7	32.0
		<u>140.4</u>	<u>125.0</u>	<u>140.6</u>	<u>146.2</u>
CURRENT ASSETS					
Stocks of finished goods		5.5	5.8	5.6	5.8
Debtors - due within one year	12	42.6	39.8	25.3	19.7
- due after one year	12	0.0	0.0	62.9	0.0
Fixed term deposits	13	92.8	116.0	92.8	116.0
Cash at bank and in hand		26.2	14.6	22.3	11.4
		<u>167.1</u>	<u>176.2</u>	<u>208.9</u>	<u>152.9</u>
LESS CREDITORS: amounts falling due within one year	14	<u>102.3</u>	<u>111.5</u>	<u>145.4</u>	<u>110.8</u>
NET CURRENT ASSETS		<u>64.8</u>	<u>64.7</u>	<u>63.5</u>	<u>42.1</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>205.2</u>	<u>189.7</u>	<u>204.1</u>	<u>188.3</u>
LESS CREDITORS: amounts falling due after more than one year	15	<u>62.7</u>	<u>62.8</u>	<u>60.0</u>	<u>60.0</u>
TOTAL NET ASSETS		<u>142.5</u>	<u>126.9</u>	<u>144.1</u>	<u>128.3</u>
DEFERRED CAPITAL GRANTS	16	<u>48.0</u>	<u>41.8</u>	<u>48.0</u>	<u>41.8</u>
RESERVES					
Revaluation reserve	17	9.0	10.5	9.0	10.5
General funds		85.5	74.6	87.1	76.0
TOTAL RESERVES		<u>94.5</u>	<u>85.1</u>	<u>96.1</u>	<u>86.5</u>
		<u>142.5</u>	<u>126.9</u>	<u>144.1</u>	<u>128.3</u>

The accounting policies on pages 20 to 23 and the notes on pages 27 to 41 form an integral part of these financial statements, which were approved by Council on 6 December 2006 and signed on its behalf by:

R DELBRIDGE
Treasurer

M S HEDGES
Finance Director

B M GOURLEY
Vice-Chancellor

THE OPEN UNIVERSITY

CONSOLIDATED CASH FLOW STATEMENT for the Year Ended 31 July 2006

	NOTES	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
NET CASH (OUTFLOW)/INFLOW FROM OPERATING ACTIVITIES	18	<u>(1.4)</u>	<u>2.7</u>
RETURN ON INVESTMENTS AND SERVICING OF FINANCE			
Interest received		5.9	8.3
Interest paid		<u>(3.0)</u>	<u>(3.0)</u>
NET CASH INFLOW FROM RETURNS ON INVESTMENT AND SERVICING OF FINANCE		<u>2.9</u>	<u>5.3</u>
TAX PAID		<u>(0.1)</u>	<u>(0.0)</u>
CAPITAL EXPENDITURE			
Payments to acquire tangible assets		(23.9)	(17.7)
Deferred capital grants received		<u>11.0</u>	<u>7.8</u>
NET CASH (OUTFLOW) FROM CAPITAL EXPENDITURE		<u>(12.9)</u>	<u>(9.9)</u>
CASH (OUTFLOW) BEFORE MANAGEMENT OF LIQUID RESOURCES		(11.5)	(1.9)
MANAGEMENT OF LIQUID RESOURCES			
Cash transferred from/(to) term deposits		23.2	(2.5)
FINANCING			
Bank loan drawn down in year		0.0	2.8
Loan repayment in the year		<u>(0.1)</u>	<u>(2.8)</u>
INCREASE/(DECREASE) IN CASH IN THE YEAR	19,20	<u>11.6</u>	<u>(4.4)</u>

The accounting policies on pages 20 to 23 and the notes on pages 27 to 41 form an integral part of these financial statements.

1 FUNDING COUNCIL GRANTS

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Recurrent grants		
Higher Education Funding Council for England	160.7	156.0
Scottish Funding Council	16.2	15.8
Higher Education Funding Council for Wales	6.8	0.0
Training and Development Agency for Schools	2.5	2.4
Department of Employment and Learning (Northern Ireland)	0.2	0.0
	<u>186.4</u>	<u>174.2</u>
Specific grants		
Higher Education Funding Council for England	11.0	5.8
Scottish Funding Council	0.7	0.5
Higher Education Funding Council for Wales	0.2	0.0
	<u>11.9</u>	<u>6.3</u>
Deferred capital grants released in year		
Higher Education Funding Council for England (see also Note 16)		
Buildings	2.1	1.5
Equipment	0.7	0.7
	<u>2.8</u>	<u>2.2</u>
	<u>201.1</u>	<u>182.7</u>

2 ACADEMIC & OTHER FEES

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Student fees		
United Kingdom	98.2	98.9
Overseas	16.9	16.0
Learning material sales	0.5	0.6
Research training support grants	0.0	0.0
	<u>115.6</u>	<u>115.5</u>

3 RESEARCH GRANTS & CONTRACTS

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Research Councils	5.3	4.6
Other sources, including industrial companies	5.2	3.8
	<u>10.5</u>	<u>8.4</u>

4 OTHER OPERATING INCOME

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Other grants and contracts	7.1	7.9
Royalties received	0.2	0.3
External computer services	0.2	0.1
Sub-tenants' rental and services	0.5	0.8
Validation fees	2.8	2.3
Released from deferred capital grant	0.0	0.0
Other income	8.0	7.5
	<u>18.8</u>	<u>18.9</u>

5 INTEREST RECEIVABLE

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Interest on student loans	0.9	0.9
Other interest receivable	5.8	6.8
	<u>6.7</u>	<u>7.7</u>

6 STAFF

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Staff Costs		
Salaries and other payments to employees	176.6	168.1
Social security costs	14.1	12.1
Pension costs	19.1	17.8
	<u>209.8</u>	<u>198.0</u>
Staff costs by category		
Full-time staff categories	160.4	149.6
Associate lecturers, residential school staff and examination marking fees	43.0	41.3
Other staff costs, including casual staff	5.2	6.2
Early retirement and voluntary severance	1.2	0.9
	<u>209.8</u>	<u>198.0</u>

6 STAFF (continued)

REMUNERATION OF HIGHER PAID EMPLOYEES

The emoluments of Professor Brenda Gourley, the Vice-Chancellor, included in the above costs are £199,000 (year ended 31 July 2005, £185,000). These emoluments are shown on the same basis as for higher paid staff. The University's pension contributions to the Universities Superannuation Scheme in respect of the Vice-Chancellor are paid at the same rates as for other academic staff and amounted to £28,000 (year ended 31 July 2005, £25,000). The aggregate of these sums is £227,000 (year ended 31 July 2005, £210,000).

Compensation for loss of office paid to UK based employees earning in excess of £70,000 and funded from general income was £Nil (year ended 31 July 2005, £65,000).

The remuneration of other higher paid employees, excluding the University's pension contributions, was:

	Staff Numbers 31 July 2006	Staff Numbers 31 July 2005
£70,000 - £79,999	34	17
£80,000 - £89,999	9	4
£90,000 - £99,999	5	5
£100,000 - £109,999	1	1
£110,000 - £119,999	0	1
£120,000 - £129,999	1	0
	<hr/>	<hr/>

AVERAGE STAFF NUMBERS

Full-time and part-time staff at Milton Keynes, Wellingborough and regional centres	4,648	4,494
Associate lecturers and residential school staff	6,639	6,522
	<hr/>	<hr/>
	11,287	11,016

7 OTHER OPERATING EXPENSES

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Consumables and staff support	40.9	37.7
Course materials and residential schools	18.3	21.7
Student publications and recruitment	13.2	14.5
Financial assistance to students	3.0	2.9
Books and periodicals	1.2	1.2
Audio visual production	7.4	6.7
Heat, light, water and power	2.0	1.5
Repairs, general maintenance and equipment	18.0	16.9
Rents and rates	8.4	8.9
Students' association grant	0.7	0.7
Auditors' remuneration		
Audit fees - Group	0.1	0.1
Audit fees - Other regulatory audits	0.0	0.0
Fees for UK taxation advice	0.0	0.2
Fees for overseas taxation advice	0.1	0.1
Other expenses	<u>8.5</u>	<u>7.1</u>
	<u>121.8</u>	<u>120.2</u>

Included in the above are audit fees in respect of the University only of £0.1 million (year ended 31 July 2005, £0.1 million).

8 INTEREST PAYABLE

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
On bank loans, overdrafts and other loans: Repayable wholly or partly in more than 5 years	<u>3.1</u>	<u>3.5</u>

9 TAXATION

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Foreign taxes	<u>0.1</u>	<u>0.0</u>

The foreign tax is withholding tax on royalty income received by Open University Worldwide Limited.

10 TANGIBLE ASSETS

CONSOLIDATED

	Freehold Land and Buildings £m	Buildings in the Course of Construction £m	Equipment £m	Total £m
Cost and valuation				
At 1 August 2005	144.2	4.8	14.1	163.1
Additions	18.4	4.2	1.3	23.9
Transfers	4.8	(4.8)	0.0	0.0
Disposals	<u>(0.9)</u>	<u>(0.0)</u>	<u>(0.0)</u>	<u>(0.9)</u>
At 31 July 2006	<u>166.5</u>	<u>4.2</u>	<u>15.4</u>	<u>186.1</u>
Depreciation				
At 1 August 2005	25.9	0.0	12.2	38.1
Charge for year	6.8	0.0	1.7	8.5
Disposals	<u>(0.9)</u>	<u>(0.0)</u>	<u>(0.0)</u>	<u>(0.9)</u>
At 31 July 2006	<u>31.8</u>	<u>0.0</u>	<u>13.9</u>	<u>45.7</u>
Net book amount				
At 31 July 2006	<u>134.7</u>	<u>4.2</u>	<u>1.5</u>	<u>140.4</u>
At 31 July 2005	<u>118.3</u>	<u>4.8</u>	<u>1.9</u>	<u>125.0</u>
Financed by capital grants	43.4	3.8	0.8	48.0
Financed from other sources	<u>91.3</u>	<u>0.4</u>	<u>0.7</u>	<u>92.4</u>
Net book amount				
At 31 July 2006	<u>134.7</u>	<u>4.2</u>	<u>1.5</u>	<u>140.4</u>

One building has been partially funded with the aid of a grant of £0.3 million from the Wolfson Foundation. Land and buildings which have been funded from Treasury sources amount to £68.0 million. In the event that these were to be sold, the University would either have to surrender the proceeds to the Treasury or use them in accordance with the Financial Memorandum with HEFCE.

There is £9.3 million of future capital expenditure for which contracts had been placed at 31 July 2006 (year ended 31 July 2005, £3.9 million).

10 TANGIBLE ASSETS (continued)

UNIVERSITY

	Freehold Land and Buildings £m	Buildings in the Course of Construction £m	Equipment £m	Total £m
Cost and valuation				
At 1 August 2005	132.1	4.8	14.0	150.9
Additions	18.4	4.2	1.3	23.9
Transfers	4.8	(4.8)	0.0	0.0
Disposals	<u>(0.9)</u>	<u>(0.0)</u>	<u>(0.0)</u>	<u>(0.9)</u>
At 31 July 2006	<u>154.4</u>	<u>4.2</u>	<u>15.3</u>	<u>173.9</u>
Depreciation				
At 1 August 2005	24.7	0.0	12.0	36.7
Charge for year	6.5	0.0	1.7	8.2
Disposals	<u>(0.9)</u>	<u>(0.0)</u>	<u>(0.0)</u>	<u>(0.9)</u>
At 31 July 2006	<u>30.3</u>	<u>0.0</u>	<u>13.7</u>	<u>44.0</u>
Net book amount				
At 31 July 2006	<u>124.1</u>	<u>4.2</u>	<u>1.6</u>	<u>129.9</u>
At 31 July 2005	<u>107.4</u>	<u>4.8</u>	<u>2.0</u>	<u>114.2</u>
Financed by capital grants	43.4	3.8	0.8	48.0
Financed from other sources	<u>80.7</u>	<u>0.4</u>	<u>0.8</u>	<u>81.9</u>
Net book amount				
At 31 July 2006	<u>124.1</u>	<u>4.2</u>	<u>1.6</u>	<u>129.9</u>

If the land and buildings had not been revalued, they would have been included at the following amounts:

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Cost	153.0	132.0
Aggregate depreciation	<u>33.5</u>	<u>29.5</u>
Net book amount	<u>119.5</u>	<u>102.5</u>

11 INVESTMENTS

	UNIVERSITY	
	As At	As At
	31 July 2006	31 July 2005
	£m	£m
Shares in wholly owned subsidiary companies:		
Open University Student Budget Accounts Limited	0.5	0.5
Open University Worldwide Limited	0.3	0.3
Open University Business School Limited	0.0	0.0
Open University Properties (Walton Drive) Limited	9.7	9.7
Long term loans:		
Open University Student Budget Accounts Limited	0.0	20.0
Open University Worldwide Limited	0.2	1.5
	10.7	32.0

Open University Student Budget Accounts Limited is registered in England and Wales and was established to provide students with a deferred payment facility. Around 30% of the students use this facility. The company operates under the Consumer Credit Act. The existing long-term loan was repaid during the year.

Open University Worldwide Limited is registered in England and Wales and is engaged in the commercial exploitation of the University's intellectual property assets through collaboration with partners overseas or direct sales of course materials. The company is also engaged in other trading activities and is partly financed by a long-term loan that carries interest at a fixed rate of 10% per annum.

Open University Business School Limited is registered in England and Wales and is dormant.

OU Properties (Walton Drive) Limited is registered in England and Wales and owns a specific office building which is occupied by the University and Open University Worldwide Limited. The purchase of the building was financed by a share issue.

In addition the University has the following subsidiaries that do not have share capital or loans disclosed above but whose results, assets and liabilities are included in the consolidated group financial statements:

OU Properties (Bristol) Limited is registered in England and Wales and owns a specific office building which is leased to the University. It is financed through a specific bank facility.

Bookhire Limited is registered in England and Wales, is limited by guarantee and has no share capital. It provides library services to the University, including the provision of books and premises.

12 DEBTORS

	CONSOLIDATED		UNIVERSITY	
	As At	As At	As At	As At
	31 July 2006	31 July 2005	31 July 2006	31 July 2005
	£m	£m	£m	£m
DEBTORS				
Students' loan accounts	18.1	19.9	0.0	0.0
Fee debtors	0.7	0.7	0.7	0.7
Amounts due from subsidiaries	0.0	0.0	2.9	2.8
Other debtors	17.8	14.4	16.0	11.7
	<u>36.6</u>	<u>35.0</u>	<u>19.6</u>	<u>15.2</u>
PREPAYMENTS AND ACCRUED INCOME	6.0	4.8	5.7	4.5
	<u>42.6</u>	<u>39.8</u>	<u>25.3</u>	<u>19.7</u>
TOTAL DUE WITHIN ONE YEAR				
Amounts due from subsidiaries after one year	0.0	0.0	62.9	0.0

Students' loan accounts represent amounts due from students paying instalments under credit terms with The Open University's subsidiary company, Open University Student Budget Accounts Limited.

In July 2006 the University refinanced its two main operating subsidiaries, Open University Student Budget Accounts Limited and Open University Worldwide Limited. The former subsidiary replaced its existing loan from the University with £60.0 million borrowed at an interest rate equal to base rate. The latter subsidiary borrowed an additional £1.5 million at an interest rate equal to 1% over base rate. These loans are repayable in 2016.

There are no material debtors and prepayments denominated in currencies other than sterling.

13 FIXED TERM DEPOSITS

	CONSOLIDATED		UNIVERSITY	
	As At	As At	As At	As At
	31 July 2006	31 July 2005	31 July 2006	31 July 2005
	£m	£m	£m	£m
Deposits maturing:				
In one year or less	75.8	107.0	75.8	107.0
Between one and two years	17.0	9.0	17.0	9.0
	<u>92.8</u>	<u>116.0</u>	<u>92.8</u>	<u>116.0</u>

Fixed term deposits are held with banks and building societies operating in the London market and licensed by the Financial Services Authority with more than 24 hours maturity at the balance sheet date. The interest rates for these deposits are fixed for the duration of the deposit at time of placement.

At 31 July 2006 the weighted average interest rate of these fixed rate deposits was 4.73% per annum and the remaining weighted average period for which the interest rate is fixed on these deposits was 229 days. The fair value of these deposits was not materially different from the book value.

14 CREDITORS: amounts falling due within one year

	CONSOLIDATED		UNIVERSITY	
	As At 31 July 2006 £m	As At 31 July 2005 £m	As At 31 July 2006 £m	As At 31 July 2005 £m
Trade creditors	6.9	12.2	6.8	12.1
Other creditors and accruals	43.0	43.8	43.8	44.4
Income in advance	15.1	16.2	15.1	16.2
Deferred income	37.3	39.3	36.6	38.1
Amounts due to subsidiaries	0.0	0.0	43.1	0.0
	102.3	111.5	145.4	110.8

A provision for fee debts of £1.4m (year ended 31 July 2005, £1.1m) in respect of student loans in the accounts of Open University Student Budget Accounts Limited is included as a creditor in the University's balance sheet, as the University bears the ultimate liability for the company's bad debts. Debtors in the consolidated balance sheet are shown net of the provision for bad debts.

Amounts due to subsidiaries represent surplus funds lent by the subsidiaries to the University under the terms of the loan agreements referred to in Note 12.

There are no material creditors denominated in currencies other than sterling.

15 CREDITORS: amounts falling due after more than one year

	CONSOLIDATED		UNIVERSITY	
	As At 31 July 2006 £m	As At 31 July 2005 £m	As At 31 July 2006 £m	As At 31 July 2005 £m
Long-term loans	62.7	62.8	60.0	60.0

The Group has two long-term loan facilities.

A bank loan to the University of £60.0 million (31 July 2005, £60.0 million) is secured on a portfolio of buildings within the Walton Hall campus in Milton Keynes, denominated in sterling and repayable in 20 annual instalments commencing on 31 July 2009 and ending on 31 July 2028. The loan carries interest at a pre-agreed margin over LIBOR.

A bank loan to OU Properties (Bristol) Limited totalling an aggregate of £2.8 million due within one year and due after more than one year (31 July 2005, £3.0 million) is secured on a single office building, denominated in sterling and repayable in 80 quarterly instalments commencing on 1 October 2005 and ending on 1 July 2025. The rate of interest is fixed to the lenders base rate.

At 31 July 2006 the weighted average interest rate of these loans was 4.91% per annum. The interest rate on the £60.0 million loan was fixed for a further 31 days at 31 July 2006.

16 DEFERRED CAPITAL GRANTS

	CONSOLIDATED AND UNIVERSITY		
	Funding Councils and TDA £m	Other £m	Total £m
At 1 August 2005			
Buildings	39.8	0.5	40.3
Equipment	<u>1.3</u>	<u>0.2</u>	<u>1.5</u>
Total	<u>41.1</u>	<u>0.7</u>	<u>41.8</u>
Cash Receivable			
Buildings	9.2	0.0	9.2
Equipment	<u>0.0</u>	<u>0.2</u>	<u>0.2</u>
Total	<u>9.2</u>	<u>0.2</u>	<u>9.4</u>
Released to Income and Expenditure			
Buildings	(2.1)	(0.2)	(2.3)
Equipment	<u>(0.7)</u>	<u>(0.2)</u>	<u>(0.9)</u>
Total	<u>(2.8)</u>	<u>(0.4)</u>	<u>(3.2)</u>
At 31 July 2006			
Buildings	46.9	0.3	47.2
Equipment	<u>0.6</u>	<u>0.2</u>	<u>0.8</u>
Total	<u>47.5</u>	<u>0.5</u>	<u>48.0</u>

17 RESERVES

	CONSOLIDATED	UNIVERSITY
	£m	£m
REVALUATION RESERVE		
At 1 August 2005	10.5	10.5
Transfer to General Funds:		
On disposal of fixed assets	(0.4)	(0.4)
In respect of depreciation for this year	<u>(1.1)</u>	<u>(1.1)</u>
At 31 July 2006	<u>9.0</u>	<u>9.0</u>
GENERAL FUNDS		
At 1 August 2005	74.6	76.0
Surplus for the year	9.4	9.6
Transfer from revaluation reserve	<u>1.5</u>	<u>1.5</u>
At 31 July 2006	<u>85.5</u>	<u>87.1</u>

**18 RECONCILIATION OF SURPLUS BEFORE TAX
TO NET CASH (OUTFLOW)/ INFLOW FROM OPERATING ACTIVITIES**

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Surplus for the year before tax	9.5	4.7
Depreciation	8.5	6.8
Deferred capital grant released to income	(3.2)	(2.6)
Investment income	(6.7)	(7.7)
Interest payable	3.1	3.5
Decrease in stock	0.3	1.2
(Increase) in debtors	(3.7)	(3.2)
(Decrease) in creditors	(9.2)	(0.0)
	<u>(1.4)</u>	<u>2.7</u>

19 RECONCILIATION TO NET FUNDS

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Increase/(Decrease) in cash in the year	11.6	(4.5)
Cash (inflow)/outflow from movement from liquid resources	(23.2)	2.5
Cash (inflow) from new bank loan	0.0	(2.8)
Loan repayment in year	0.1	2.8
	<u>(11.5)</u>	<u>(2.0)</u>
Change in net funds		
Net funds at 1 August	<u>67.8</u>	<u>69.8</u>
Net funds at 31 July	<u>56.3</u>	<u>67.8</u>

20 ANALYSIS OF CHANGES IN NET FUNDS

	At 1 August 2005 £m	Cash Flows £m	At 31 July 2006 £m
Cash at bank and in hand	14.6	11.6	26.2
Fixed term deposits	116.0	(23.2)	92.8
Bank loans	<u>(62.8)</u>	<u>0.1</u>	<u>(62.7)</u>
Total	<u>67.8</u>	<u>(11.5)</u>	<u>56.3</u>

21 COMMITMENTS

LEASEHOLD PROPERTIES

During the year ended 31 July 2006 the Group paid £4.5 million (year ended 31 July 2005, £4.9 million), in respect of operating leases for long-leasehold properties.

The Group has obligations for annual payments under non-cancellable operating leases in respect of long-leasehold properties as follows:

	Year Ended 31 July 2006	Year Ended 31 July 2005
	£m	£m
Expiring:		
within 1 year	0.4	0.5
between 2 and 5 years	0.4	0.7
over 5 years	3.5	3.8
Total	4.3	5.0

A number of the property leases are subject to periodic rent reviews.

OTHER COMMITMENTS

The University has provided a loan facility of £10.0 million to U M Association (Special Risks) Limited (UMA(SR)L) for the period 1 August 2005 to 31 July 2007. The facility can be drawn down by UMA(SR)L on giving not less than six months notice: no such notice has been received in this regard. Any loan drawn down by UMA(SR)L would be repayable, with interest at an agreed margin over base rate, in quarterly instalments over a maximum of seven years. UMA(SR)L provides discretionary indemnities on a mutual basis for UK universities and its financial commitments are supported by the joint and several liability of all its members.

22 AMOUNTS DISBURSED AS AGENT

The Funding Councils and TDA grants and bursaries are available solely for students: the University acts only as paying agent. The grants and bursaries and related disbursements are therefore excluded from the Income and Expenditure Account; the balances carried forward are set out below and are included in both current assets and in creditors falling due within one year and so there is no effect on net current assets. The separate HEFCE, SFC, HEFCW and TDA grants for the costs of administering the above items are included in the Income and Expenditure Account, as set out in Note 1.

HEFCE ACCESS FOR LEARNING

	Year Ended 31 July 2006	Year Ended 31 July 2005
	£m	£m
Balance brought forward	2.7	3.0
Funding Council Grants	(0.6)	1.1
Disbursed to Students	(1.3)	(1.4)
Balance carried forward	0.8	2.7

22 AMOUNTS DISBURSED AS AGENT (continued)

SFC ACCESS FUNDS

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Balance brought forward	(0.1)	(0.1)
Funding Council Grants	1.4	1.2
Disbursed to Students	<u>(1.4)</u>	<u>(1.2)</u>
Balance carried forward	<u>(0.1)</u>	<u>(0.1)</u>

HEFCW ACCESS FUNDS

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Balance brought forward	0.0	0.0
Funding Council Grants	0.1	0.0
Disbursed to Students	<u>(0.1)</u>	<u>0.0</u>
Balance carried forward	<u>0.0</u>	<u>0.0</u>

TDA TRAINING BURSARIES

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Balance brought forward	0.6	1.5
TDA Grants	0.8	0.3
Disbursed to Students	<u>(1.1)</u>	<u>(1.2)</u>
Balance carried forward	<u>0.3</u>	<u>0.6</u>

TDA SPECIALIST SHORTAGE SUBJECT SCHEME GRANTS

	Year Ended 31 July 2006 £m	Year Ended 31 July 2005 £m
Balance brought forward	0.1	0.3
Grant Income received/refunded	0.1	(0.1)
Disbursed to Students	<u>(0.1)</u>	<u>(0.1)</u>
Balance carried forward	<u>0.1</u>	<u>0.1</u>

23 RELATED PARTY TRANSACTIONS

Due to the nature of the University's operations and the composition of the Council (being drawn from both public and private sector organisations) it is inevitable that transactions will take place with organisations in which a member of Council may have an interest. All transactions in which a member of Council may have an interest are conducted at arm's length and in accordance with the University's financial regulations and normal procurement procedures.

Mr M S Hedges, Finance Director, is a director of U M Association (Special Risks) Limited and commitments in respect of this company are disclosed in Note 21.

24 PENSION SCHEMES

In the United Kingdom, the University participates in a national multi-employer defined benefit pension scheme, the Universities Superannuation Scheme (USS), and in a defined contribution pension scheme, the Federated Superannuation System for Universities (FSSU). A small number of overseas employees are also members of defined contribution schemes.

Defined Contribution Schemes

A small number of employees are members of the FSSU, which is administered by trustees and has assets independent of the University.

A small number of employees in the Republic of Ireland are members of The Open University Retirement Solution Plan. It is established under irrevocable trusts, of which the University is a co-trustee.

A small number of overseas based employees are members of defined contribution schemes in the countries in which they are employed.

The total pension cost for all these defined contribution schemes was £0.1m (year ended 31 July 2005, £0.1m).

Defined Benefit Pension Scheme

Universities Superannuation Scheme

The University participates in the USS, a defined benefit scheme which is externally funded and contracted out of the State Second Pension. The assets of the scheme are held in a separate trustee-administered fund. It is not possible to identify each participating employer's share of the underlying assets and liabilities of the scheme on a consistent and reasonable basis and therefore, as required by FRS 17 *Retirement Benefits*, the University accounts for USS as if it were a defined contribution scheme. As a result, the amount charged to the Income and Expenditure Account for the accounting period represents the contributions payable to the scheme in respect of the accounting period.

The latest actuarial valuation of the scheme was at 31 March 2005, by an independent qualified actuary. The assumptions that have the most significant effect on the result of the valuation are those relating to the rate of return on investments and the rates of increase in salaries and pensions. In relation to the past service liabilities, the financial assumptions were derived from market yields prevailing at the valuation date. It was assumed that the rate of return on investments would be 4.5% per annum, salary increases would be 3.9% per annum plus an additional allowance for increases in salaries due to age and promotion in line with recent experience and pensions would increase by 2.9% per annum. In relation to the future service liabilities, it was assumed that the rate of return on investments would be 6.2% per annum, including an additional investment return assumption of 1.7% per annum, salary increases would be 3.9% per annum and pensions would increase by 2.9% per annum. The valuation was carried out using the projected unit method.

24 PENSION SCHEMES (continued)

At the valuation date, the market value of the assets of the scheme was £21,740 million and the value of the past service liabilities was indicating a deficit of £6,568 million. The assets therefore were sufficient to cover 77% of the benefits which had accrued to members after allowing for expected future increases in earnings.

The actuary also valued the scheme on a number of other bases at the valuation date. Using the Minimum Funding Requirement prescribed assumptions introduced by the Pensions Act 1995, the scheme was 126% funded at that date; under the Pension Protection Fund regulations introduced by the Pensions Act 2004 it was 110% funded; on a buy-out basis (i.e. assuming the scheme discontinued on the valuation date) the assets would have been approximately 74% of the amount necessary to secure all the USS benefits with an insurance company; and using the FRS17 formula as if USS was a single employer scheme, the actuary estimated that the funding level would have been approximately 90%.

The institution contribution rate required for future service benefits alone at the date of the valuations was 14.3 % of pensionable salaries, but the trustee company, on the advice of the actuary, decided to maintain participating employers' contribution rate at 14% of pensionable salaries.

Surpluses or deficits which arise at future valuations may impact the University's future contribution commitment. An additional factor which could impact the funding level of the scheme is that with effect from 16 March 2006, USS positioned itself as a 'last man standing' scheme so that in the event of the insolvency of any of the participating employers in the USS, the amount of any pension funding shortfall (which cannot be otherwise recovered) in respect of that employer will be spread across the remaining participating employers and reflected in the next valuation of the scheme.

The next formal triennial actuarial valuation is due as at 31 March 2008. The contribution rate will be reviewed as part of each valuation.

The total pension cost for the University was £19.1 million (year ended 31 July 2005 £17.8 million). Of this figure, £0.4 million (year ended 31 July 2005, £0.9 million) related to costs in respect of early retirement.