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HIGHLANDS AND ISLANDS AIRPORTS LIMITED

ANNUAL REPORT AND ACCOUNTS

2002/2003



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Contents

Page

2	Operating Loss and Capital Expenditure by Airport
3	Directors' Report
7	Statement on Internal Control
10	Directors' Responsibilities
11	Profit and Loss Account
12	Balance Sheet
13	Cash Flow Statement
14	Notes to the Accounts
30	Economic Regulation Statement
31	Five Year Summary
32	Independent Auditors' Report

DIRECTORS

Alex Matheson OBE (Aged 61) Chairman
Chairman, Roderick Smith Limited
Chairman, Harris Tweed Authority
Director, UHI Millennium Institute

Robert M Macleod (63) Managing Director

William Brackenridge (55)

Stuart Edmond MBE (66)
Non-Executive Director, Highland Acute Hospitals
Trust (to 31/01/03)

Grenville S Johnston OBE TD DL CA (58)
Consultant, Johnston Carmichael
Director, The Multimedia Team Limited (to 31/12/02)
Director, NMS Enterprises Limited
Director, Cairngorm Mountain Limited

Shona MacLennan (40)
Director, Solas Business Services Limited
Director, Grampian Television Limited

COMPANY SECRETARY

A John Burns

REGISTERED OFFICE

Inverness Airport
Inverness IV2 7JB
Registered in Scotland Number 97647

AUDITORS

Ernst and Young LLP
Moray House
16 Bank Street
Inverness
IV1 1QY

OPERATING LOSS AND CAPITAL EXPENDITURE BY AIRPORT

2002/2003

AIRPORTS	Turnover	Revenue		Capital Expenditure	Operating (Loss) plus Capital Expenditure per Airport
		Operating Costs	Operating (Loss)		
	£000	£000	£000	£000	£000
BARRA	112	(695)	(583)	(42)	(625)
BENBECULA	546	(1,794)	(1,248)	(744)	(1,992)
CAMPBELTOWN	152	(902)	(750)	(42)	(792)
INVERNESS	3,829	(7,307)	(3,478)	(1,537)	(5,015)
ISLAY	167	(1,090)	(923)	(2,558)	(3,481)
KIRKWALL	893	(3,172)	(2,279)	(1,611)	(3,890)
STORNOWAY	1,025	(3,339)	(2,314)	(1,090)	(3,404)
SUMBURGH	2,005	(5,382)	(3,377)	(292)	(3,669)
TIREE	86	(816)	(730)	(92)	(822)
WICK	414	(2,046)	(1,632)	(1,219)	(2,851)
	9,229	(26,543)	(17,314)	(9,227)	(26,541)
WORKING CAPITAL MOVEMENT					493
DEPRECIATION					899
TOTAL SUBSIDIES RECEIVABLE					25,149

DIRECTORS' REPORT

The Directors submit their Report and Accounts for the period 1 April 2002 to 31 March 2003.

The Directors submit their Report and Accounts for the period 1 April 2002 to 31 March 2003.

The trading loss for the period, after taking account of taxation, amounted to £1,304,000. The directors recommend that no dividend be paid, leaving the full amount to be set against reserves.

Subsidies from the Scottish Ministers received for the year ended 31 March 2003 totalled £24,050,000 made up of revenue subsidy of £15,845,000 and capital subsidy of £8,205,000

Non-oil related passenger numbers and aircraft movements rose by 6.5% and 3.2% respectively. Sumburgh oil-related passenger numbers and aircraft movements declined by 42.5% and 30.6% respectively.

Overall, passenger numbers increased by 3.9% in the year.

CAPITAL EXPENDITURE

Investment in new fixed assets amounted to £9,227,000. Expenditure was incurred on major items as follows:-

- a) At Islay runways 13/31 and 08/26 were resurfaced during the year at a cost of £2,134,000
- b) At Inverness, Kirkwall and Stornoway airports work commenced on the provision of Landing Aids.
At Inverness and Kirkwall costs to date of £1,339,000 and £1,074,000 respectively were incurred on the installation of Instrument Landing Systems (ILS). Capital contributions towards the Kirkwall ILS were received from the Public Transport Fund via Orkney Islands Council (£600,000) and Orkney Enterprise (£100,000)
At Stornoway, costs to date of £446,000 were incurred on the installation of Localisers.
- c) At Benbecula the first phase of coastal protection work was completed at a cost of £580,000
- d) Environmental measures were carried out at Wick at a cost to date of £755,000
- e) Work commenced on the construction of a new Fire Service and Engineering Building at Kirkwall at a cost to date of £307,000
- f) The phased programme of installation of new fire training grounds continued. Work commenced on ground works at Wick at a cost of £296,000 in the year.
- g) Work commenced on an extension to the terminal building at Islay in response to increased security and operational requirements at a cost to date of £219,000
- h) At Sumburgh improvements to the arrivals and departure areas within the terminal building were completed at a cost of £120,000. A contribution of £36,715 was received from Shetland Enterprise towards these improvements.

- i) Final costs of £222,000 in connection with the provision of new terminal buildings at Kirkwall and Stornoway were incurred in the year. Capital contributions of £196,000 through the Highlands and Islands Special Transitional Programme 2000-2006 of the European Regional Development Fund and £65,000 from Comhairle Nan Eilean Siar, Visit Hebrides and Western Isles Enterprise were receivable as final contributions towards these projects.

AIRPORT CONSULTATIVE COMMITTEES

Airport Consultative Committees are maintained at each airport. These provide a forum for the discussion of all matters concerning the development or operation of the airport, which have an impact on the users of the airport and on people living and working in the surrounding area. Consultative Committees are a means of keeping all interested parties informed of matters affecting them, of providing an opportunity to reconcile differences of view and resolve difficulties.

SAFETY

The company is committed to ensuring, as far as is reasonably practicable, a high standard of health, safety and welfare for members of the public, all employees and others affected by its undertakings.

CREDITOR PAYMENT POLICY AND PRACTICE

It is company policy that payments to suppliers are made in accordance with terms and conditions agreed between the company and its suppliers, provided that all trading terms and conditions have been complied with.

At 31 March 2003 the company had an average of 15 days' purchases outstanding in trade creditors.

PERSONNEL

At the year-end the total staff establishment stood at 297, showing an increase of 11 on the total establishment for the previous year. This was mainly due to the Company continuing to implement regulatory increases to the Airport Fire Service at our airports and also for the introduction of shift work at Kirkwall and Stornoway. Staff have also been increased at some airports to take over responsibility for meteorological observations previously carried out by the Met Office.

Over the course of the year we recruited to fill 20 permanent full time posts plus a number of temporary fixed term, part time and relief employees to cover air traffic control and other temporary shortages, while 12 left the company including medical retirements and resignations.

Promotions, including acting promotions, re-grading and transfers resulted in a further 36 staff changes.

TRAINING AND DEVELOPMENT

The company attaches high importance to training and development for all staff.

Training courses are normally undertaken as a result of regulatory requirements, such as the phased training of fire service personnel undertaken internally or at the Fire Training School or specific aviation security courses. In addition to these aspects, the company recruits and trains air traffic controllers. Non mandatory training and development is also carried out.

EMPLOYMENT POLICIES

As a company HIAL promotes equality of opportunity. This includes equality of opportunity for people with disabilities within the workplace from the initial recruitment stage through to development and career progression within the company.

We work closely with the Employment Service Disability Employment Adviser to make our workplaces accessible.

For those employees who have become disabled during the time they have been employed by the company we employ a *policy of finding suitable alternative employment and retraining wherever possible.*

Career development and training is encouraged where appropriate with all HIAL employees and the company takes steps to ensure that disability is not a barrier to taking advantage of the opportunities available.

Communication to staff flows through the management structure of the company on a regular basis either through line management or through the functional grouping (AFS, ATC, Engineering etc).

The company recognises three Trades Unions (PCS, Prospect, and T&G) and encourages all staff to be a member of the appropriate trade union. Joint management/Trades Union meetings are held quarterly and others as required.

INVESTORS IN PEOPLE

The company has undertaken initial assessment for Investors in People accreditation and is striving towards full Investors in People status. The company is embarking on a process of improving current processes and procedures to ensure that any benefit accrued from gaining Investors in People status is maximised and maintained.

PAY STRUCTURE STUDY

The company's recent pay structure study has brought systems into line with the Modernising Government Initiative for the public sector.

GOING CONCERN

The company sets an annual budget which aims to balance income, expenditure and subsidy provisions set by government. Future operational and legislative requirements are addressed in a ten year corporate plan which includes provision for revenue and capital items such as major repairs to runways or new or replacement equipment. The subsidy provisions for the year to March 2003 were £21.5 million increased during the year to £25.75 million. £24.05 million was drawn down during the year. The company has applied to carry forward the balance of £1.7 million to meet future expenditure on landing aids at Inverness, Kirkwall and Stornoway and on provision of fire grounds. The subsidy provisions have been set at £20.9 million for the year ending March 2004. This is considered by the directors to be adequate to sustain the company as a going concern.

AUDITORS

Ernst & Young LLP were reappointed as auditors at the Annual General Meeting on 26 July 2002. A resolution to reappoint Ernst & Young LLP will be laid before the Annual General Meeting on 25 July 2003.

DIRECTORS AND THEIR INTERESTS

The directors who served during the year to 31 March 2003 and subsequently are:

Alex Matheson, Chairman

Robert M Macleod, Managing Director

William Brackenridge, Director

Stuart Edmond, Director

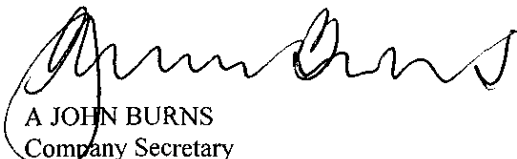
Grenville S Johnston, Director

Shona MacLennan, Director

None of the directors had an interest in the share capital of the Company.

The Register of Directors' interests may be examined by prior arrangement with the Company Secretary during normal office hours at the Registered Office of the company.

By order of the board



A JOHN BURNS
Company Secretary
13 June 2003

STATEMENT ON INTERNAL CONTROL

As Accountable Officer I have responsibility for maintaining a sound system of internal control that supports the achievement of the company's policies, aims and objectives agreed between the Board and the Scottish Ministers, whilst safeguarding the public funds and assets for which I am personally responsible, in accordance with the responsibilities assigned to me.

The system of internal control seeks as far as is reasonably practicable to eliminate the risk of failure to achieve the company's policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness.

The system of internal control is based on an ongoing process designed to identify the principal risks to the achievement of the company's policies, aims and objectives, to evaluate the nature and extent of those risks and to manage them efficiently, effectively and economically. This process which has been fully in place since 14 March 2003 accords with guidance from Scottish Ministers and has continued up to the date of approval of the annual report and accounts.

As Accountable Officer I also have responsibility for reviewing the effectiveness of the system of internal control. My review of the system of internal control is informed by:

- The work of the internal managers within the company who have responsibility for the development and maintenance of the internal control framework,
- Comments made by the external and internal auditors in their management letters and other reports

The following processes are established:

The Board

The Board is responsible for determining the business strategy of the company, taking into account the Scottish Ministers expressed policy to encourage economic and social development in the Highlands and Islands.

The Board is composed of six members appointed by the Scottish Ministers. The six members are the non-executive chairman, the managing director and four non-executive directors. The Board meets on a six weekly cycle and has adopted a policy of requiring all significant matters to be referred to the Board for decision unless these are specifically within delegated limits given to the managing director.

Board Committees

The Audit Committee is composed of three non-executive directors: Mr G S Johnston, Mr S Edmond and Ms S MacLennan. The Committee, chaired by Mr G S Johnston, works to terms of reference agreed by the Board and meets on a regular basis. The managing director and the company secretary are normally invited to attend meetings. The

Committee receives regular reports from both the internal and external auditors and makes periodic reports concerning internal control to the Board. The Committee reviews and comments to the Board as to corporate governance compliance and the adequacy of risk management arrangements.

The Assessor

An Assessor appointed by the Scottish Ministers is entitled to attend but not vote at any meeting of the company or its directors.

Risk Management

The managing director, senior managers and appropriate line managers are responsible for the effective management of risk within the Company and ensure that appropriate procedures, resources and skills are introduced and maintained to achieve this.

Policy aims and objectives adopted by the Board in relation to risk are:

- Raising awareness of the need for risk management throughout the company
- Enabling the Board of directors and management of the company to anticipate and respond to changing social, environmental and legislative conditions
- Minimisation of the risks of injury, damage, loss of facilities and inconvenience to staff, service providers and service users arising from the provision of company facilities and services
- Application of a documented robust framework and procedures for identification, analysis, assessment and management of risk
- Minimisation of the cost of things going wrong
- Preparation of a risk register for the company
- ongoing maintenance and review of the risk register

Formal reporting lines on risk follow existing management structures. Strategic risk is managed and reviewed at Board level. Clear responsibilities, roles and reporting lines have been established across all departments and services provided including a framework that addresses the following issues:

- Assessment of the different types of risk – strategic and operational;
 - How these risks will be managed and evaluated;
 - Board and Departmental roles and accountabilities;
 - Prompt reporting of accidents, near misses and losses.
- Provision for risk assessment in all decision-making processes of the Company;
- Measurement of performance in risk management activities against the aims and objectives;
- Ensuring all relevant external agencies contracted to provide services to the Company are aware of the Company's expectations on risk;
- Investigation into incidents and revisiting and adjusting control measures as appropriate;

- Tasking managers with bringing forward for assessment hazards not previously dealt with;
- Revisiting Risk assessments annually. Significant changes in hazards will be considered at the time of the change;
- Laying the Risk Register before the Audit Committee and Board annually;

The Board will review the risk management policy statement annually to ensure its continued relevance to the Company

Control Environment

Capable, competent personnel are viewed as an essential part of the control environment. High standards of ethical behaviour are supported by high recruitment standards and ongoing staff training and development.

The systems of internal financial control include:

- an annual budget approved by the Board
- regular consideration by the Board of actual and budget results
- delegated financial authorities
- clearly defined procurement and evaluation procedures

Monitoring systems used by the Board

The Board at its regular meetings deals with issues of risk and internal control on an ongoing basis. In particular, it reviews safety, financial performance including variances from budget, commercial and marketing information and objectives, acquisitions and disposals as necessary, environmental and regulatory issues, business planning and strategies.

The management team led by the Managing Director monitors financial performance by a system of monthly financial reporting and review together with forward projections.

Internal Audit

The internal audit concentrates on areas determined by analysis of the degree of risk and in accordance with the internal audit plan considered by the Audit Committee and approved by the Board. The Audit Committee enhances the independence and value of internal audit and provides a forum for senior management to discuss internal control including issues raised by internal audit.

Operational Control

Each of the airports under the company's control is subject to regular operational inspections by the Civil Aviation Authority as regulator.



R M Macleod
Managing Director

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ACCOUNTS

Company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing those accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the accounts;
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

GROUP PROFIT AND LOSS ACCOUNT
FOR THE YEAR 1 APRIL 2002 TO 31 MARCH 2003

	Note	Group 2003 £000	Group 2002 £000
TURNOVER			
Traffic operations and other charges		9,229	9,063
Total subsidies receivable		25,149	21,963
Less Capital subsidies carried to deferred income:			
Scottish Ministers		8,205	7,173
European Regional Development Fund		196	2,283
Other		802	208
		9,203	9,664
Revenue subsidies from Scottish Ministers and others	(2)	15,946	12,299
		25,175	21,362
DIRECT OPERATING COSTS		23,406	20,213
GROSS PROFIT		1,769	1,149
ADMINISTRATIVE EXPENSES		3,137	2,610
OPERATING (LOSS)	(3)(4)	(1,368)	(1,461)
INTEREST RECEIVABLE		64	54
(LOSS) ON ORDINARY ACTIVITIES BEFORE TAX		(1,304)	(1,407)
TAX ON ORDINARY ACTIVITIES	(7)	-	-
(LOSS) FOR THE FINANCIAL YEAR		(1,304)	(1,407)

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

There are no gains or losses other than the loss attributable to the shareholder of the group of £1,304,000 for the year ended 31 March 2003 and the loss of £1,407,000 for the year ended 31 March 2002.

Notes 1 to 20 form part of these accounts

GROUP AND COMPANY BALANCE SHEETS
AS AT 31 MARCH 2003

	Note	Group and Company 2003 £000	Group 2002 £000	Company 2002 £000
FIXED ASSETS				
Tangible assets	(8)	34,826	28,689	28,689
Investments	(9)	—	—	50
		34,826	28,689	28,739
CURRENT ASSETS				
Debtors	(10)	2,515	1,763	1,763
Cash in hand		1,336	1,166	1,166
		3,851	2,929	2,929
CREDITORS: Amounts falling due within one year	(11)	2,348	1,019	1,077
NET CURRENT ASSETS		1,503	1,910	1,852
TOTAL ASSETS LESS CURRENT LIABILITIES		36,329	30,599	30,591
PROVISION FOR LIABILITIES AND CHARGES	(12)	-	-	-
ACCRUALS AND DEFERRED INCOME				
Deferred Government subsidies	(13)	30,386	23,352	23,352
		5,943	7,247	7,239
CAPITAL AND RESERVES				
Share capital	(14)	50	50	50
Profit and loss account	(15)	5,893	7,197	7,189
TOTAL SHAREHOLDER'S EQUITY		5,943	7,247	7,239

Alex Matheson

Alex Matheson, **Chairman**

Robert M Macleod

Robert M Macleod, **Managing Director**
13 June 2003

Notes 1 to 20 form part of these accounts

GROUP CASH FLOW STATEMENT
FOR THE YEAR 1 APRIL 2002 TO 31 MARCH 2003

	Note	2003 £000	2002 £000
NET CASH (OUTFLOW) INFLOW FROM OPERATING ACTIVITIES	(4.2)	(636)	139
RETURNS ON INVESTMENTS AND SERVICING OF FINANCE			
Interest received		63	58
CAPITAL EXPENDITURE			
Purchase of tangible fixed assets		(8,511)	(9,522)
Receipt of capital subsidy: Scottish Ministers		8,205	7,173
European Regional Development Fund		200	2,118
Other		826	197
Sale of tangible fixed assets		<u>23</u>	<u>37</u>
		<u>743</u>	<u>3</u>
INCREASE IN CASH		<u>170</u>	<u>200</u>
RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET FUNDS			
		£000	£000
Increase in cash in the period		170	200
Net funds at 1 April		1,166	966
		<u>1,336</u>	<u>1,166</u>
Net funds at 31 March		<u>1,336</u>	<u>1,166</u>

Notes 1 to 20 form part of these accounts

NOTES TO THE ACCOUNTS

BASIS OF PREPARATION

1. ACCOUNTING POLICIES

1.1 Accounting Conventions

The accounts are prepared in accordance with the historical cost convention and in accordance with applicable accounting and financial reporting standards

1.2 Basis of Operations

The company receives subsidies from the Scottish Ministers on an annual basis. The annual accounts are prepared on the assumption that the company will continue to receive such subsidies for the foreseeable future.

1.3 Government Subsidies

Subsidies in respect of capital expenditure are credited to a deferred income account and released to the profit and loss account over the estimated useful lives of the relevant assets.

Subsidies for revenue expenditure are separately disclosed within turnover in the period to which they relate.

1.4 Pension Costs

The cost of providing pension benefits is charged to the profit and loss account so as to spread the cost over the employees' working life with the company.

1.5 Leases

The rentals on operating leases are charged to the profit and loss account as incurred.

1.6 Tangible Fixed Assets

Tangible fixed assets are stated at cost.

Depreciation is provided on tangible fixed assets to spread the cost by equal annual instalments over their estimated useful lives, as follows:

Freehold buildings	20 years
Leasehold land and buildings	over the remaining life of the lease to a maximum of 20 years
Navigation aids	7 years
Plant and other equipment	3-10 years
Vehicles	5 years
Runways, aprons and main services	7-25 years
Runway bases	100 years

The following categories of tangible fixed assets are not depreciated:

Freehold land

Furniture, fixtures and fittings

Initial purchases of furniture, fixtures and fittings are treated as tangible fixed assets; replacement expenditure is charged to the profit and loss account. Items that are disposed of and not replaced are eliminated from tangible fixed assets.

Net Depreciation (as disclosed in Note 3) includes: depreciation charge for the year, profit on disposal or loss on scrapping of fixed assets and release of deferred government subsidies.

NOTES TO THE ACCOUNTS

1.7 Deferred Taxation

Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements. Deferred tax assets and liabilities are not discounted.

1.8 Basis of Consolidation

The group accounts consolidate the results of Highlands and Islands Airports Limited and its subsidiary undertaking Airport Management Services Limited for the year ended 31 March 2003. No individual profit and loss account is presented for Highlands and Islands Airports Limited as permitted in section 230 of the Companies Act 1985. The company loss for the year was £1,296,000

2. TURNOVER

Traffic operating and other charges represents amounts received and receivable (stated net of value added tax) *in respect of airport services provided in the UK.*

Revenue subsidies from Scottish Ministers and others represent a revenue subsidy of £15,845,000 received from the Scottish Ministers in accordance with Section 34 of the Civil Aviation Act 1982 and £101,000 received from Inverness & Nairn Enterprise towards route and marketing support.

3 OPERATING RESULTS - YEAR TO 31 MARCH 2003

	Total		Subsidy received from SE		Barra		Benbecula		Campbeltown		Inverness	
	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Turnover												
Airport charges - non-oil related	7,795	7,363	-	-	107	102	463	401	144	113	3,595	3,531
Airport charges - oil related	630	862	-	-	-	-	2	-	-	-	-	-
Other income	804	838	-	-	5	5	81	57	8	3	234	219
Subsidies receivable	15,946	12,299	15,845	12,277	-	-	-	-	-	-	101	7
	25,175	21,362	15,845	12,277	112	107	546	458	152	116	3,930	3,757
Operating costs												
Staff costs	12,257	10,440	-	-	402	326	1,003	820	494	426	2,769	2,412
Property rates	733	695	-	-	6	4	34	36	10	18	247	236
Security, utilities, materials	5,696	4,891	-	-	88	77	248	191	112	108	2,658	2,425
Repairs and maintenance	3,609	3,219	-	-	96	76	241	471	195	131	608	733
Net depreciation	899	1,039	-	-	14	15	54	84	2	-	250	258
Other operating costs	3,349	2,539	-	-	89	61	214	162	89	74	775	488
	26,543	22,823	-	-	695	559	1,794	1,764	902	757	7,307	6,552
Operating (loss) profit	(1,368)	(1,461)	15,845	12,277	(583)	(452)	(1,248)	(1,306)	(750)	(641)	(3,377)	(2,795)

	Islay	Kirkwall			Stornoway			Sumburgh			Tiree			Wick		
		2002	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002	2003	2002
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
147	133	801	724	907	798	1,270	1,220	70	66	291	275					
-	-	15	19	24	-	504	722	-	-	85	121					
20	18	77	76	94	112	231	261	16	16	38	71					
-	-	-	-	-	5	-	10	-	-	-	-					
167	151	893	819	1,025	915	2,005	2,213	86	82	414	467					
553	517	1,702	1,310	1,539	1,223	2,235	1,928	326	306	1,234	1,172					
20	20	106	89	82	73	182	171	13	12	33	36					
138	135	581	427	710	407	874	883	79	81	208	157					
207	142	408	350	642	397	697	545	220	136	295	238					
71	74	74	82	85	103	157	232	71	71	121	120					
101	92	301	181	281	208	1,237	1,063	107	60	155	150					
1,090	980	3,172	2,439	3,339	2,411	5,382	4,822	816	666	2,046	1,873					
(923)	(829)	(2,279)	(1,620)	(2,314)	(1,496)	(3,377)	(2,609)	(730)	(584)	(1,632)	(1,406)					

NOTES TO THE ACCOUNTS

	Group and Company 2003 £000	Group and Company 2002 £000
4. GROUP OPERATING LOSS		
4.1 This is stated after charging:		
Depreciation	3,015	2,732
Auditors' remuneration	10	8
Non audit fees payable to auditors	-	1
Loss on scrapping of fixed assets	65	9
And after crediting:		
Government subsidies released	2,168	1,694
Profit on disposal of fixed assets	13	10
	Group and Company 2003 £000	Group and Company 2002 £000
4.2 Reconciliation of operating loss to net cash inflow from operating activities		
Operating (loss)	(1,368)	(1,461)
Depreciation	3,015	2,732
Net Loss on disposal / scrapping of tangible fixed assets	52	-
Deferred Government subsidies released	(2,168)	(1,694)
(Increase) Decrease in debtors	(781)	234
Increase in creditors	614	328
Net cash (outflow) inflow	<u>(636)</u>	<u>139</u>
	Group and Company 2003 £000	Group and Company 2002 £000
5. STAFF COSTS		
Wages and salaries	8,226	7,230
Social security costs	614	557
Pension costs (note 16)	2,635	1,951
Other staff costs	782	702
	<u>12,257</u>	<u>10,440</u>

The average number of employees during the period was 284 (2002: 256).

NOTES TO THE ACCOUNTS

	Group and Company 2003 £000	Group and Company 2002 £000
6. DIRECTORS' EMOLUMENTS		
Emoluments	132	127
Pension contributions	23	17
Directors' emoluments, including pension contributions, fell within the following ranges:		
	2003	2002
	No.	No.
£0 - £5,000	-	1
£5,001 - £10,000	4	4
£15,001 - £20,000	1	1
£95,001 - £100,000	-	1
£105,001 - £110,000	1	-

The emoluments of the Chairman were £19,721 (2002: £19,240) including pension contributions of £nil (2002 : £Nil) and of the highest paid director, Robert M Macleod, were £109,367 (2002: £98,446) including pension contributions of £22,508 (2002: £17,308).

Mr R M Macleod is the only director for whom the company makes contributions who is a member of the Civil Aviation Authority Pension Scheme. As at 31 March 2003 Mr Macleod's entitlements were:

- Increase in accrued pension £1,316
- Total accrued pension £6,663

7. TAX ON ORDINARY ACTIVITIES

There is no tax charge for the year as the company has incurred tax losses and the related deferred tax asset has not been recognised. Tax losses carried forward at 31 March 2003 were approximately £6 million.

7.1 Factors affecting Tax Charge for the period

The tax assessed for the period is lower than that resulting from applying the standard rate of corporation tax in the United Kingdom – 30% (2002 – 30%)

The differences are explained below:	Group and Company 2003 £000	Group and Company 2002 £000
(Loss) on ordinary activities before tax	<u>(1,304)</u>	<u>(1,407)</u>
Tax at 30% thereon:	391	422
Effects of:		
Expenses not deductible for tax purposes	(17)	(4)
Capital allowances in excess of depreciation	(134)	(174)
Utilisation of tax losses	(215)	(238)
Grant release on assets disposed of	<u>(25)</u>	<u>(6)</u>
Current tax charge for period	<u>-</u>	<u>-</u>

8. TANGIBLE FIXED ASSETS

	Land & Buildings Free- Hold £ 000	Nav aids £ 000	Plant and other equipment vehicles furniture £ 000	Runways aprons and main services £ 000	Assets in course of construction and installation £ 000	Total £ 000
Cost						
At 1 April 2002	17,629	2,255	13,954	14,728	2,303	50,869
Additions during year	416	32	825	2,758	5,196	9,227
Disposals during year	(4)	(9)	(496)			(509)
Transfers during year	65	149	245	540	(999)	
	18,106	2,427	14,528	18,026	6,500	59,587
Depreciation						
At 1 April 2002	(5,072)	(1,985)	(9,455)	(5,668)		(22,180)
Provided during year	(859)	(94)	(1,147)	(915)		(3,015)
Disposals during year	4	9	421			434
	(5,927)	(2,070)	(10,181)	(6,583)		(24,761)
Net book value						
at 31 March 2003	12,179	357	4,347	11,443	6,500	34,826
Net book value						
at 31 March 2002	12,557	270	4,499	9,060	2,303	28,689

The net book value of freehold land and buildings includes £303,679 in respect of land (2002: £240,521).

NOTES TO THE ACCOUNTS

	Company 2003 £000	Company 2002 £000
9. INVESTMENTS		
Shares at cost	<u>-</u>	<u>50</u>

The subsidiary undertaking at 31 March 2003 was:

	Country of Incorporation	Nature of Business	Proportion of shares held
Airport Management Services Limited	Scotland	Airport management	100%

The attributable capital and reserves of the above at 31 March 2003 was £NIL (2002: £57,952). The loss for the year was £57,952.

	Group and Company 2003 £000	Group and Company 2002 £000
10. DEBTORS		
Trade debtors	895	761
Prepayments and accrued income	194	139
Other debtors	1,426	863
	<u>2,515</u>	<u>1,763</u>

	Group and Company 2003 £000	Group 2002 £000	Company 2002 £000
11. CREDITORS			
Amounts falling due within one year			
Trade creditors	953	373	373
Other creditors	24	8	8
Other taxes and social security costs	246		
Due to subsidiary undertaking	-	-	58
Accruals and deferred income	1,125	638	638
	<u>2,348</u>	<u>1,019</u>	<u>1,077</u>

NOTES TO THE ACCOUNTS

	Group and Company 2003 £000	Group and Company 2002 £000
12. PROVISION FOR LIABILITIES AND CHARGES		
Analysis of deferred tax balances		
- capital allowances in advance of depreciation	210	343
- short term timing differences	-	-
- trading losses	(210)	(343)
	<hr/>	<hr/>
	<u>-</u>	<u>-</u>

A deferred tax asset has not been recognised in respect of timing differences related to trading losses incurred by the company (and not used against accelerated capital allowances) as there is insufficient evidence that the asset will be recovered. The estimated value of the deferred tax asset not recognised, measured at a standard rate of 30% is £1,691,000. The asset would be recovered if the company began to make significant profits.

	Group and Company 2003 £000	Group and Company 2002 £000
13. DEFERRED GOVERNMENT SUBSIDIES		
Balance at 1 April	23,352	15,381
Subsidies Receivable: Scottish Ministers	8,205	7,173
European Regional Development Fund	195	2,283
Other	802	209
Released to profit and loss account	(2,168)	(1,694)
	<hr/>	<hr/>
Balance at 31 March	<u>30,386</u>	<u>23,352</u>

	Company			
	Authorised		Issued and fully paid	
	2003	2002	2003	2002
	Number	Number	£000	£000
Ordinary shares of £1 each	<u>50,000</u>	<u>50,000</u>	<u>50</u>	<u>50</u>

NOTES TO THE ACCOUNTS

15. SHARE CAPITAL, MOVEMENT ON RESERVES AND RECONCILIATION OF MOVEMENT IN SHAREHOLDER'S FUNDS

	Company Share Capital	Group Profit and Loss account	Company Profit and Loss account	Group Total Share- holder's Funds	Company Total Share- holder's Funds
	£000	£000	£000	£000	£000
At 1 April 2001	50	8,604	8,595	8,654	8,645
(Loss) attributable to the shareholder	-	(1,407)	(1,406)	(1,407)	(1,406)
At 31 March 2002 and 1 April 2002	50	7,197	7,189	7,247	7,239
(Loss) attributable to the shareholder	-	(1,304)	(1,296)	(1,304)	(1,296)
At 31 March 2003	<u>50</u>	<u>5,893</u>	<u>5,893</u>	<u>5,943</u>	<u>5,943</u>

16. PENSION COSTS

The group has continued to account for pensions in accordance with Statement of Standard Accounting Practice 24 (SSAP 24) "Accounting for pension costs". The disclosures required by that standard are shown in 16.1 below. Financial Reporting Standard 17 (FRS 17) "Retirement Benefits" was issued in November 2000 but will not require full implementation for the Group and Company until the year ended 31 March 2006. Prior to this, phased transitional disclosures are required. The disclosures required are in 16.2 below.

16.1 SSAP 24 disclosures

	Group and Company 2003 £000	Group and Company 2002 £000
Ordinary contributions to the pension scheme	<u>2,635</u>	<u>1,951</u>

When ownership of the company was transferred from the Civil Aviation Authority to the Secretary of State for Scotland on 1 April 1995, the company continued to participate in the Civil Aviation Authority Pension Scheme, a defined benefit scheme in the UK, on a "non-associated employer" basis.

The pension costs are assessed in accordance with the advice of a professional qualified actuary using the projected unit method. The latest actuarial assessment of the scheme was at 31 March 2001. The assumptions that have significant effect on the results of the valuation are those relating to the rate of return on investments and the rates of increase in salaries and pensions. It was assumed that the investment return before retirement would be 1.9% higher than the annual increase in the level of salaries and the post retirement investment return would be 1.8% higher than the annual increase in present and future pensions.

At 31 March 2001 the market value of the assets notionally attributed to provide for the liabilities in respect of the active members of the Civil Aviation Authority Pension Scheme employed by the company was £25.2 million.

The actuarial value of the assets was sufficient to cover 103% of the benefits that had accrued to members, after allowing for expected future increases in earnings. This surplus would be eliminated by 2022 at an employer's contribution rate of 33.5% of earnings. Contributions to the pension scheme are calculated at a rate of 33.5% (2002: 33.5%) of pensionable salaries.

NOTES TO THE ACCOUNTS

16.2 FRS 17 disclosures

A full actuarial valuation was carried out at 31 March 2001. The valuation has been updated to 31 March 2003 in accordance with FRS 17 by a qualified independent actuary. The major assumptions used by the actuary were:

	2003 % pa	2002 % pa
Rate of increase in salaries	4.1	4.3
Rate of increase in pensions in payment and deferred pensions	2.7	2.9
Discount rate	5.4	6.0
Inflation assumption	2.6	2.8

The assets and liabilities of the scheme in respect of the company's members and the expected rates of return were:

	2003		2002 As restated	
	Long-term rate of return expected	Value	Long term rate of return expected	Value
	%	£000	%	£000
Equities	7.5	17,300	8.0	21,300
Other	6.0	3,800	5.8	3,800
		<hr/>		<hr/>
Total market value of scheme assets		21,100		25,100
Present value of scheme liabilities		(27,600)		(21,300)
		<hr/>		<hr/>
(Deficit) Surplus in the scheme		(6,500)		3,800
Related deferred tax (asset) liability		(1,950)		1,140
		<hr/>		<hr/>
Net pension (liability) asset		<u>(4,550)</u>		<u>2,660</u>

NOTES TO THE ACCOUNTS

Had the company adopted FRS 17 early the balance sheet information and profit and loss reserves would have been:

Balance Sheet Presentation

	2003	2002
		as restated
	£000	£000
Net assets excluding pension asset	5,943	7,247
Pension (liability) asset	(4,550)	2,660
	<hr/>	<hr/>
Net assets including pension asset	<u>1,393</u>	<u>9,907</u>

Reserves note

	2003	2002
		as restated
	£000	£000
Profit and loss reserve excluding pension asset	5,893	7,197
Pension reserve (net of related deferred tax liability)	(4,550)	2,660
	<hr/>	<hr/>
Profit and loss reserve including pension asset	<u>1,343</u>	<u>9,857</u>

The market value of the assets at 31 March 2003 has been calculated based on legal advice received by the Trustees' on the method of valuing the HIAL notional fund. The 2002 figures have been restated accordingly.

Analysis of the amount charged to operating profit

	2003
	£000
Current service cost	2,100
Past service cost	-
	<hr/>
Total operating charge	<u>2,100</u>

Analysis of the amount credited to other finance income

	2003
	£000
Expected return on pension scheme assets	2,000
Interest on pension scheme liabilities	(1,300)
	<hr/>
Net return	<u>700</u>

NOTES TO THE ACCOUNTS

Analysis of amount recognised in statement of total recognised gains and losses (STRGL)

	2003
	£000
Actual return less expected return on pension scheme assets	(8,400)
Experience gains and losses arising on the scheme liabilities	(300)
Changes in assumptions underlying the present value of the scheme liabilities	(2,900)
	<hr/>
Actuarial loss recognised in STRGL	<u>(11,600)</u>

Movement in (deficit) surplus during the year	2003
	£000
Surplus in scheme at beginning of the year	3,800
Movement in year:	
Current service costs	(2,100)
Contributions	2,700
Past service costs	-
Other finance income	700
Actuarial loss	<u>(11,600)</u>
Deficit in scheme at end of year	<u>(6,500)</u>

History of experience gains and losses

	2003
Difference between the actual and expected return on scheme assets:	
amount (£000)	(8,400)
percentage of scheme assets	(40)%
Experience gains and losses on scheme liabilities:	
Amount (£000)	(300)
Percentage of the present value of the scheme liabilities	(1)%
Total amount recognised in statement of total recognised gains and losses	
amount (£000)	(11,600)
percentage of the present value of the scheme liabilities	(42)%

NOTES TO THE ACCOUNTS

	Group and Company 2003 £000	Group and Company 2002 £000
17. CAPITAL COMMITMENTS		
Contracted	<u>445</u>	<u>324</u>
18. OTHER FINANCIAL COMMITMENTS		
<p>The Inverness terminal passenger facility is operated under a Private Finance Initiative contract. The contract commenced on 23 May 1999 and expires 22 May 2024 and provides for the availability of the terminal facility services at Inverness airport. If expansion of the facility takes place within the last 5 years of the term this will be extended by 5 years. The capital cost of the terminal was £9,600,000 as at May 1999. During the year the company incurred £1,365,000 (2002: £1,302,000) in charges based on passenger throughput for the provision of agreed terminal services. Due to the nature of the contract, the company's annual commitment is variable. The minimum payment to be incurred in 2003/04 will be £1,393,000</p> <p>Under the terms of the above contract the company has granted a floating charge over its whole assets to Inverness Air Terminal Limited (the operator of the Inverness terminal passenger facility) as security for payments due to Inverness Air Terminal Limited.</p>		
19. RELATED PARTIES		
(a) During the year the company received subsidies totalling £24,050,000 from the Scottish Ministers.		

NOTES TO THE ACCOUNTS

20. CURRENT COST INFORMATION

The following summarised current cost information reflects the restatement of the company's fixed assets at valuations as noted below, together with the resultant restatement of capital grants.

This information is presented as a supplementary note demonstrating the consequential effect on the company's loss for the year and total net assets based on restating fixed assets and capital subsidies.

The company's fixed assets have been independently valued by DTZ Debenham Tie Leung Limited in accordance with Financial Reporting Standard 15 and the RICS Appraisal and Valuation Manual and appropriate RICS Practice Statements. A full valuation was carried out as at 31 March 1999 and 31 March 2000. An interim valuation of land and buildings and runways, aprons and mains services was carried out by DTZ as at 31 March 2003. As permitted by the standard the directors have applied appropriate indices to the 2000 valuation for plant and equipment, vehicles, furniture and navigational aids to arrive at the valuation for 2003.

Fixed assets and capital subsidies have been revalued on the following bases:

Land and buildings:

Non specialised properties have been revalued at existing use values.

Specialised properties have been revalued at depreciated replacement cost.

Properties held as investments or surplus to operational requirements have been revalued at open market value.

Navigational Aids:

Revalued at net current replacement cost.

Plant and other equipment, vehicles, furniture:

Revalued at net current replacement cost.

Runways, aprons and mains services:

Revalued at depreciated replacement cost.

Capital subsidies:

Revalued at the rate at which subsidies were available to the company calculated on the revalued cost of the relevant asset.

The annual difference between the historical cost depreciation charge and release of deferred government subsidies, and the relevant amounts under current cost accounting basis have been reflected in the cumulative current cost reserve. This reserve comprises the net movement in the balance sheet for the restatement of fixed assets and deferred government subsidies as outlined above. No current cost gearing or monetary working capital adjustments have been incorporated.

Depreciation on a current cost basis has been calculated for 2003 by the application of historical cost asset / depreciation relationships. The 2002 figures have been restated accordingly.

SUMMARISED CURRENT COST PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31 MARCH 2003

	2003	2002
		as restated
	£000	£000
HISTORICAL COST LOSS BEFORE TAXATION	(1,304)	(1,407)
Adjustment in respect of depreciation	(6,477)	(5,527)
Adjustment in respect of capital subsidies	<u>4,658</u>	<u>3,426</u>
CURRENT COST LOSS BEFORE TAXATION	(3,123)	(3,508)
Taxation	—	—
CURRENT COST LOSS FOR THE FINANCIAL YEAR	<u>(3,123)</u>	<u>(3,508)</u>

NOTES TO THE ACCOUNTS
CURRENT COST BALANCE SHEET

AS AT 31 MARCH 2003

	2003	2002
		as restated
	£000	£000
FIXED ASSETS		
Land and buildings	25,860	26,550
Navigational aids	1,354	1,312
Plant and other equipment, vehicles, furniture	5,741	5,478
Runways, aprons and main services	99,975	90,005
Assets in course of construction	<u>6,500</u>	<u>2,303</u>
	139,430	125,648
CURRENT ASSETS		
Debtors	2,515	1,763
Cash in hand	<u>1,336</u>	<u>1,166</u>
	3,851	2,929
CREDITORS: amounts falling due within one year	<u>2,348</u>	<u>1,019</u>
NET CURRENT ASSETS	<u>1,503</u>	<u>1,910</u>
TOTAL ASSETS LESS CURRENT LIABILITIES	140,933	127,558
ACCRUALS AND DEFERRED INCOME		
Deferred Government subsidies	<u>121,654</u>	<u>102,271</u>
	<u>19,279</u>	<u>25,287</u>
CAPITAL AND RESERVES		
Called up share capital	50	50
Profit and Loss Account	2,770	3,689
Current cost reserve	<u>16,459</u>	<u>21,548</u>
	<u>19,279</u>	<u>25,287</u>

NOTES TO THE ACCOUNTS

ECONOMIC REGULATION STATEMENT

FOR THE YEAR 1 APRIL 2002 TO 31 MARCH 2003

Highlands and Islands Airports Limited is subject to economic regulation under the Airports Act 1986 which requires the company to hold permissions from the Civil Aviation Authority to levy airport charges.

Operational activities are required to be allocated between airport charges levied in connection with the landing, parking and taking-off of aircraft (including passenger related charges) and other operational income.

All revenue and costs from non-operational activities, such as items where the income is not primarily from airport users, is required to be shown in a separate category.

Costs have been apportioned on a basis obtained by the analysis of 1994/95 actual expenditure.

	£000	£000
AIRPORT OPERATIONAL ACTIVITIES		
Airport Income		
Airport charges	8,425	
Subsidies	<u>15,946</u>	
	24,371	
Costs	<u>25,481</u>	<u>(1,110)</u>
Other Income		
Revenue	804	
Costs	<u>1,062</u>	<u>(258)</u>
NON-OPERATIONAL ACTIVITIES		
The Group has no such activities under the Act		-
Group operating loss for the period		<u><u>(1,368)</u></u>

Unless specified elsewhere in these accounts, the Group received no preferential treatment or financial support from any associated person or organisation during the period of these accounts.

GROUP FIVE YEAR SUMMARY

RESULTS TO 31 MARCH

PROFIT AND LOSS ACCOUNT	2003 £000	2002 £000	2001 £000	2000 £000 As restated	1999 £000
Traffic operations and other charges	9,229	9,063	8,186	9,037	9,863
Total subsidies received	25,149	21,963	15,185	12,430	6,179
less Capital subsidies	9,203	9,664	4,199	3,710	700
Revenue subsidies	15,946	12,299	10,986	8,720	5,479
Less: net operating costs	26,543	22,823	20,351	18,710	15,863
Operating (loss)	(1,368)	(1,461)	(1,179)	(953)	(521)
Interest receivable	<u>64</u>	<u>54</u>	<u>53</u>	<u>39</u>	<u>65</u>
(Loss) for the financial year	<u>(1,304)</u>	<u>(1,407)</u>	<u>(1,126)</u>	<u>(914)</u>	<u>(456)</u>

BALANCE SHEET

Tangible fixed assets	34,826	28,689	21,924	19,946	15,112
Net current assets	1,503	1,910	2,111	2,326	2,122
Accruals and deferred income	<u>30,386</u>	<u>23,352</u>	<u>15,381</u>	<u>12,492</u>	<u>6,540</u>
	<u>5,943</u>	<u>7,247</u>	<u>8,654</u>	<u>9,780</u>	<u>10,694</u>
Share capital	50	50	50	50	50
Reserves	<u>5,893</u>	<u>7,197</u>	<u>8,604</u>	<u>9,730</u>	<u>10,644</u>
Total shareholder's equity	<u>5,943</u>	<u>7,247</u>	<u>8,654</u>	<u>9,780</u>	<u>10,694</u>

	2003	2002	2001	2000	1999
Total passengers	864,301	832,140	782,460	860,939	946,463
Total aircraft movements	76,119	74,978	71,995	77,704	82,733

**INDEPENDENT AUDITORS' REPORT TO
THE MEMBER OF HIGHLANDS AND ISLANDS AIRPORTS LIMITED**

We have audited the group's financial statements for the year ended 31 March 2003 which comprise the Group Profit and Loss Account, Group Balance Sheet, Company Balance Sheet, Group Cash Flow Statement, Group Statement of Total Recognised Gains and Losses and related notes 1 to 20. These financial statements have been prepared on the basis of the accounting policies set out therein.

This report is made solely to the company's member, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's member those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's member as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities the company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

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 Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the group is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

We review whether the statement on page 7 complies with Scottish Executive guidance on statements of system of internal control. We report if it does not comply with the guidance, or if the statement is misleading or inconsistent with other information we are aware of from our audit.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. 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 directors 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 which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the company and of the group as at 31 March 2003 and of its loss of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985; and
- in all material aspects, the expenditure and income presented in the financial statements have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.
- we have also examined the alternative accounting information in note 20 which in our opinion has been properly prepared in accordance with the accounting methods described there.

Other opinion

In our opinion the Economic Regulation Statement presents fairly the information set forth therein and is in accordance with the requirements of the accounts' conditions issued by the Civil Aviation Authority under section 41(1) of the Airports Act 1986.

Ernst & Young LLP