

USS

Universities Superannuation Scheme Limited

Registered no. 1167127

Directors' Report and Accounts

for the year ended 31 March 2006



REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 MARCH 2006

The directors submit their report and the accounts for the year ended 31 March 2006.

PRINCIPAL ACTIVITY

The company, which is limited by guarantee and does not have a share capital, was established to undertake and discharge the office of trustee of any superannuation scheme but in particular to act as the trustee of the Universities Superannuation Scheme (USS).

OPERATING COSTS AND REVIEW OF ACTIVITIES

The operating costs for the year amounted to £32,462,000 this amount being recoverable from USS. This compares with £25,061,000 for the year ended 31 March 2005 and represents a 30% increase in administration costs and a 30% increase in investment management costs. The increase in administration costs is due almost entirely to the payment of the Pension Protection Fund levy for the first time this year totalling £2,551,000. The levy was introduced by the Pensions Act 2004. Excluding this amount, administration costs increased by approximately 1%. The increase in investment costs is due partly to increases in the base fees of the external managers, which are linked to market values (the value of the fund rose 30% during the year), and to the performance fee for one of the managers whose performance significantly exceeded target.

There have been major legislative changes during the year to implement the government's radical revisions to the occupational pension scheme environment. Internal preparations have been undertaken to ensure that the trustee company is in a position to administer benefits in accordance with the new tax regime from 6 April 2006 (A-day) and key decisions have been taken on the extent to which the new flexibilities might be adopted within the USS rules (within the existing funding constraints). Staff have received internal training on the new arrangements, the pensions administration software has been updated to reflect the key changes in the legislation, and internal processes have been revised. A new *Guide for Members* has also been prepared, and has been distributed at the end of March 2006, and affected members have received detailed communication material. There have also been numerous regulations arising from the Pensions Act 2004 and the trustee company has been active during the year in considering various issues which arise from these new provisions and ensuring, as far as possible, that the fund is not disadvantaged by the regulations.

The officers carried out a review during the year of the potential systems to replace the scheme's existing pensions administration software, the Universal Pensions Management System (UPM) from Comino and in July 2005 the trustee company decided that Comino's replacement software, UPM version 2, was the best solution for the company's business needs. Following a detailed feasibility study and extensive contractual negotiations, the project to replace the pensions administration system commenced in February 2006 and the application was successfully implemented onto our test environment in March. The new system is expected to go live during 2007/08.

FIXED ASSETS

The details of movements in fixed assets are set out in Note 13 to the accounts.

DIRECTORS

The directors of the company during the year were as follows:

Sir Graeme Davies (chairman)	H Jacobs
Sir Martin Harris (deputy chairman)	Lady Merrison
A S Bell (to 31.7.2005)	Sir Howard Newby (to 31.1.06)
Professor John Bull	M S Potts
M Butcher	Professor Charles Sutcliffe
S Egan (from 1.2.2006)	J W D Trythall (to 31.8.05)
D Guppy (from 1.9.2005)	Baroness Warwick of Undercliffe
Mrs V Holmes (from 1.9.2005)	

Sir Graeme Davies retired as chairman on 31 March 2006 and was replaced as chairman by Sir Martin Harris on 1 April 2006. Professor Bull became deputy chairman on 1 April 2006.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the operating costs of the company for that period. In preparing those financial statements, 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 financial statements;
- prepare the financial statements 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 enable them to ensure that the financial statements 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.

AUDITORS

The auditors, KPMG LLP, have indicated their willingness to continue in office and a resolution concerning their reappointment will be proposed at the annual general meeting.

By order of the board

A handwritten signature in black ink, appearing to read 'I M Sherlock', written in a cursive style.

I M Sherlock
Secretary

27 July 2006

**STATEMENT OF OPERATING COSTS
FOR THE YEAR ENDED 31 MARCH 2006**

	Note	2006 £000	2005 £000
PERSONNEL COSTS			
Employees' emoluments	4	8,067	7,375
Directors' emoluments and expenses	5	427	438
Recruitment, training and welfare		<u>433</u>	<u>310</u>
		<u>8,927</u>	<u>8,123</u>
PREMISES COSTS			
Rent, rates, service charges and utilities		1,568	1,557
Depreciation and maintenance		<u>286</u>	<u>277</u>
		<u>1,854</u>	<u>1,834</u>
INVESTMENT COSTS			
Securities management	6	10,357	6,215
Property management		1,608	1,690
Custodial services		1,396	1,376
Legal costs - property management		521	331
- securities management		103	31
Property valuation		124	134
Investment performance measurement		79	77
Costs met by third parties	7	<u>(11)</u>	<u>(77)</u>
		<u>14,177</u>	<u>9,777</u>
OTHER COSTS			
Pension Protection Fund Levy		2,551	-
Computer and information services costs	8	2,499	2,598
Professional fees	9	1,480	1,420
Travel and car costs		510	466
Institution liaison and member communication		309	250
Telephones and postage		298	254
Office equipment		281	263
Printing and stationery		185	149
Insurances		144	194
Pensions Regulator Levy		133	-
Pensions Act Levy		-	108
FSA membership		61	77
Auditors' remuneration	10	53	51
Sundry expenditure		54	51
Profit on disposal of fixed assets		(23)	(1)
Costs met by third parties	7	<u>(1,031)</u>	<u>(553)</u>
		<u>7,504</u>	<u>5,327</u>
TOTAL OPERATING COSTS		<u>32,462</u>	<u>25,061</u>

A separate statement of total recognised gains and losses has not been presented as all gains and losses are included in the Statement of Operating Costs.

The notes on page 7 to 13 form part of these financial statements.

BALANCE SHEET - 31 MARCH 2006

	Note	2006 £000	2005 £000
ASSETS			
FIXED ASSETS			
Tangible fixed assets	13	<u>1,204</u>	<u>1,589</u>
CURRENT ASSETS			
Debtors	14	8,126	4,348
Cash at bank and in hand		<u>3</u>	<u>3</u>
		<u>8,129</u>	<u>4,351</u>
TOTAL ASSETS		<u>9,333</u>	<u>5,940</u>
LIABILITIES			
Creditors - amounts falling due within one year	15	<u>9,333</u>	<u>5,940</u>
TOTAL LIABILITIES		<u>9,333</u>	<u>5,940</u>

The notes on pages 7 to 13 form part of these financial statements.

The financial statements on pages 4 to 13 were approved by the board of directors on 27 July 2006 and were signed on its behalf by:



Martin Harris

Chairman



John Bull

Deputy Chairman

**CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 MARCH 2006**

	Note	2006 £000	2005 £000
OPERATING ACTIVITIES			
Cash received from USS		28,713	23,518
Operating costs paid	16	(28,332)	(23,048)
		<u> </u>	<u> </u>
NET CASH INFLOW FROM OPERATING ACTIVITIES		<u>381</u>	<u>470</u>
CAPITAL EXPENDITURE & FINANCIAL INVESTMENT			
Purchase of tangible fixed assets		(457)	(502)
Sale of tangible fixed assets		76	33
		<u> </u>	<u> </u>
		<u>(381)</u>	<u>(469)</u>
INCREASE IN CASH		<u>-</u>	<u>1</u>

The notes on pages 7 to 13 form part of these financial statements.

**NOTES TO THE ACCOUNTS
FOR THE YEAR ENDED 31 MARCH 2006**

- 1 The company, which is limited by guarantee and does not have a share capital, has no beneficial interest in the investments and other assets held in its name but not included in its balance sheet, since it holds these as the trustee of USS.

2 **FORMAT OF ACCOUNTS**

A Profit and Loss Account is not presented with these accounts as such a statement is inappropriate to the operations of the company. The costs incurred and the method by which they are recovered are therefore set out in the Statement of Operating Costs.

A separate note of historical cost profits and losses is not required as the accounts are prepared under the historical cost convention.

3 **ACCOUNTING POLICIES**

Accounting convention

The accounts are prepared under the historical cost convention and on the accruals basis and comply with applicable Accounting Standards in the United Kingdom which have been consistently applied.

Depreciation of fixed assets

Depreciation is calculated so as to write off the cost of fixed assets on a straight line basis over the expected economic lives of the assets concerned. The principal annual rates used for this purpose are:

	%
Office equipment	15
Alterations to rented premises	20
Computer equipment	20 and 33 1/3
Motor cars	25
Computer software	33 1/3

Operating leases

Rental costs under operating leases are charged on a straight line basis over the lease term in the Statement of Operating Costs.

Pensions

USS Ltd participates in the Universities Superannuation Scheme (USS), a defined benefit scheme which is externally funded and contracted out of the State Second Pension (S2P). The assets of the scheme are held in a separate trustee-administered fund. USS Ltd is unable to identify its share of the underlying assets and liabilities of the scheme on a consistent and reasonable basis and therefore, as required by FRS 17 "Retirement benefits", accounts for the scheme as if it were a defined contribution scheme. As a result, the amount charged to the income and expenditure account represents the contributions payable to the scheme in respect of the accounting period

4 EMPLOYEES' EMOLUMENTS 2006 2005

The average weekly number of persons employed by the company during the year (excluding directors) was

173 158

Staff costs for the above persons were:

£000 **£000**

Wages and salaries

6,508 5,874

Pension costs (superannuation contributions)

723 679

Social security costs (national insurance contributions)

637 539

Restructuring costs

199 283
8,067 7,375

Emoluments of the chief executive

2006 **2005**

£000 **£000**

T H Merchant

218 198

The emoluments of the chief executive are shown on the same basis as for higher paid staff. USS Ltd's pension contributions for the chief executive amounted to £14,784 (2005 : £14,280).

Remuneration of other higher paid staff, excluding employer's pension contributions but including benefits in kind:

	2006	2005
£70,001 - £80,000	5	7
£80,001 - £90,000	6	2
£90,001 - £100,000	3	2
£100,001 - £110,000	2	1
£110,001 - £120,000	2	5
£120,001 - £130,000	5	1
£130,001 - £140,000	1	-
£140,001 - £150,000	1	-
£160,001 - £170,000	-	1
£170,001 - £180,000	1	-
£200,001 - £210,000	-	1
£340,001 - £350,000	1	-
£390,001 - £400,000	1	-
£430,001 - £440,000	-	1

The salary figures above include bonus payments for the investment staff, totalling £751,269 (2005: £463,392), which relate directly to their contribution to fund out-performance. Both the bonus scheme and the annual outcome are reviewed by the remuneration committee.

5 DIRECTORS' EMOLUMENTS AND EXPENSES	2006	2005
	£000	£000
Fees	371	356
Employer's costs – national insurance contributions	40	38
Expenses	<u>16</u>	<u>44</u>
	<u>427</u>	<u>438</u>

Directors are remunerated on a basis which is approved by the Joint Negotiating Committee and is in accordance with the contribution which they make to the work of USS Ltd and their legal responsibilities.

No pension contributions are made on behalf of directors. As at 31 March 2006 six of the directors are members of USS either as pensioners or through their employment with the institutions.

Directors' fees charged to the accounts reflect small differences between the amounts accrued in the accounts at each year end and the amounts paid. Actual emoluments paid to each director in respect of each of the last two years were as follows:

	2006	2005
	£000	£000
Sir Graeme Davies (chairman)	45	43
H Jacobs	71	53
Professor John Bull	32	20
Sir Martin Harris (deputy chairman)	31	27
M S Potts	30	28
Professor Charles Sutcliffe	27	25
Lady Merrison	25	23
Baroness Warwick of Undercliffe	24	22
V Holmes	18	-
A S Bell	16	47
J W D Trythall	16	39
M Butcher	13	5
D Guppy	11	-
Sir Howard Newby	10	11
S Egan	2	-
C D Donald	-	<u>12</u>
	<u>371</u>	<u>355</u>

6 SECURITIES MANAGEMENT	2006	2005
	£000	£000
External manager base fees	7,674	6,131
External manager performance fees	2,338	-
Professional fees	<u>345</u>	<u>84</u>
	<u>10,357</u>	<u>6,215</u>

7 COSTS MET BY THIRD PARTIES

Costs met by third parties represent the amount paid by certain stockbrokers for the purchase of equipment and services for USS Ltd for investment management purposes out of the commission paid to them by USS.

8 COMPUTER AND INFORMATION SERVICES COSTS	2006 £000	2005 £000
Investment information services	1,154	1,109
Computer running costs	622	617
Software depreciation	260	448
Investment accounting services	312	243
Hardware depreciation	129	170
Computer bureau fees	<u>22</u>	<u>11</u>
	<u>2,499</u>	<u>2,598</u>
 9 PROFESSIONAL FEES	 2006 £000	 2005 £000
Actuarial	791	656
Legal	376	488
Committee members (other than directors)	111	114
Taxation	57	70
Member medicals	50	37
Public relations	17	15
Pensioner mortality check	-	7
Salary surveys	19	-
Other	<u>59</u>	<u>33</u>
	<u>1,480</u>	<u>1,420</u>
 10 AUDITORS' REMUNERATION	 2006 £000	 2005 £000
USS	48	46
USS Ltd	<u>5</u>	<u>5</u>
	<u>53</u>	<u>51</u>

Remuneration of the company's auditors (KPMG LLP) for provision of services other than for the audit of USS and USS Ltd was £3,500 for advice on taxation and £4,000 for actuarial training (2005:£6,800 for advice on taxation, £8,354 for recruitment advice and £2,534 for a project management course).

11 VALUE ADDED TAX

USS Ltd is registered for Value Added Tax activities and recovers a proportion of the input tax on administrative expenditure directly attributable to the scheme's investment activities.

12 TOTAL OPERATING COSTS – recoverable from USS

	2006	2005
	£000	£000

Investment management costs	20,661	15,930
Other administration costs	<u>11,801</u>	<u>9,131</u>
	<u>32,462</u>	<u>25,061</u>

Investment management costs are those costs which are directly attributable to investment activities and include relevant personnel, premises and other costs.

Included in operating costs is a charge for depreciation of £789,000 (2005: £918,000) as set out in note 12.

All of the operating costs are recoverable from USS, which at 31 March 2006 had total assets in excess of £28 billion.

13 TANGIBLE FIXED ASSETS

	Alterations to Rented Premises	Computer Equipment	Computer Software	Office Equipment	Motor Cars	Total
	£000	£000	£000	£000	£000	£000
Cost						
At 1 April 2005	2,105	1,680	1,959	1,486	459	7,689
Additions	-	97	210	43	107	457
Disposals	-	-	-	-	(193)	(193)
At 31 March 2006	<u>2,105</u>	<u>1,777</u>	<u>2,169</u>	<u>1,529</u>	<u>373</u>	<u>7,953</u>
Accumulated Depreciation						
At 1 April 2005	1,707	1,542	1,535	1,121	195	6,100
Charge for year	164	129	312	91	93	789
Disposals	-	-	-	-	(140)	(140)
At 31 March 2006	<u>1,871</u>	<u>1,671</u>	<u>1,847</u>	<u>1,212</u>	<u>148</u>	<u>6,749</u>
Net Book Value						
31 March 2006	<u>234</u>	<u>106</u>	<u>322</u>	<u>317</u>	<u>225</u>	<u>1,204</u>
Net Book Value						
31 March 2005	<u>398</u>	<u>138</u>	<u>424</u>	<u>365</u>	<u>264</u>	<u>1,589</u>

14 DEBTORS - amounts falling due within one year

	2006	2005
	£000	£000

Due from USS	7,177	3,428
Prepayments	922	893
Other debtors	<u>27</u>	<u>27</u>
	<u>8,126</u>	<u>4,348</u>

15 CREDITORS - amounts falling due within one year	2006	2005
	£000	£000
Accrued expenditure	5,606	2,824
Other creditors	3,122	2,677
Taxation and social security	<u>605</u>	<u>439</u>
	<u>9,333</u>	<u>5,940</u>

16 RECONCILIATION OF OPERATING COSTS PAID	2006	2005
	£000	£000
Operating costs - recoverable from USS	32,462	25,061
Increase in creditors	(3,393)	(779)
Profit on sale of tangible fixed assets	23	1
Depreciation	(789)	(918)
Increase/(decrease) in debtors (excluding USS)	<u>29</u>	<u>(317)</u>
Operating costs paid	<u>28,332</u>	<u>23,048</u>

17 OPERATING LEASE COMMITMENTS

USS Ltd is committed to making future annual payments under operating leases which expire as follows:-

	2006	2005
	£000	£000
Less than one year	10	10
Between two and five years	13	9
Over five years	1,211	1,211

The payments relate to ongoing rent, rate and equipment leasing commitments in respect of USS Ltd's offices in Liverpool and London.

18 PENSION COSTS

The company participates in the Universities Superannuation Scheme (USS), a defined benefit scheme which is externally funded and contracted out of the State Second Pension (S2P). The assets of the scheme are held in a separate trustee-administered fund. The company is unable to identify its share of the underlying assets and liabilities of the scheme on a consistent and reasonable basis and therefore, as required by FRS 17 "Retirement benefits", accounts for the scheme as if it were a defined contribution scheme. As a result, the amount charged to the income and expenditure account represents the contributions payable to the scheme in respect of the accounting period.

The latest actuarial valuation of the scheme was at 31 March 2005. The assumptions which have the most significant effect on the result of the valuation are those relating to the rate of return on investments (i.e. the valuation rate of interest) and the rates of increase in salary 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 valuation rate of interest 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 valuation rate of interest 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 (also plus an allowance for increases in salary due to age and promotion) and pensions would increase by 2.9% per annum. The valuation was carried out using the projected unit method.

At the valuation date, the value of the assets of the scheme was £21,740 million and the value of the past service liabilities was £28,308 million 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 as 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 (ie assuming the Scheme had 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 valuation was 14.3% of pensionable salaries but the trustee company, on the advice of the actuary, decided to maintain the institution contribution rate at 14% of pensionable salaries.

Surpluses or deficits which arise at future valuations may impact on the institution'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 USS, the amount of any pension funding shortfall (which cannot otherwise be recovered) in respect of that employer will be spread across the remaining participant employers and reflected in the next actuarial 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 company was £723,034 (2005 : £678,904). The contribution rate payable by the company was 14% of pensionable salaries.

19 RELATED PARTY TRANSACTIONS

There are no related party transactions other than transactions between the trustee company and the scheme. The trustee company provides administration and investment management services to the scheme charging £11.8 million and £21.1 million respectively, with a balance due from the scheme of £7.6 million at 31 March 2006.

20 SPECIAL PURPOSE COMPANIES

USS Ltd owns the share capital of a number of special purpose companies to aid the efficient administration of fund investments. Their results have not been consolidated with USS Ltd because they are considered to be assets of the fund. Full details of these companies may be obtained by writing to the Company Secretary of USS Ltd, Mr Ian Sherlock, at Royal Liver Building, Liverpool L3 1PY.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF UNIVERSITIES SUPERANNUATION SCHEME LIMITED

We have audited the financial statements of Universities Superannuation Scheme Limited for the year ended 31 March 2006 which comprise the Statement of Operating Costs, the Balance Sheet, the Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, 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 members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members 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 on page 2, the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. We also report to you if, in our opinion, 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 other transactions 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.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by

fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion :

- the financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 March 2006 and of its result for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the committee reports is consistent with the financial statements.

KPMG LLP

KPMG LLP
Chartered Accountants
Registered Auditor

27 July 2006