

Finance Director's report



Following two years of operating deficits arising from planned expenditure on our investment programme, the year ended 31 March 2004 saw a return to profitability with a surplus of £5.6 million. This ensured Ordnance Survey achieved the financial objective of 9% average annual ROCE over its initial five years as a Trading Fund. Turnover increased by £8 million, operating costs have been held in line with last year at £110.6 million, while investments in infrastructure and product development to deliver enhancements in customer service have progressed.

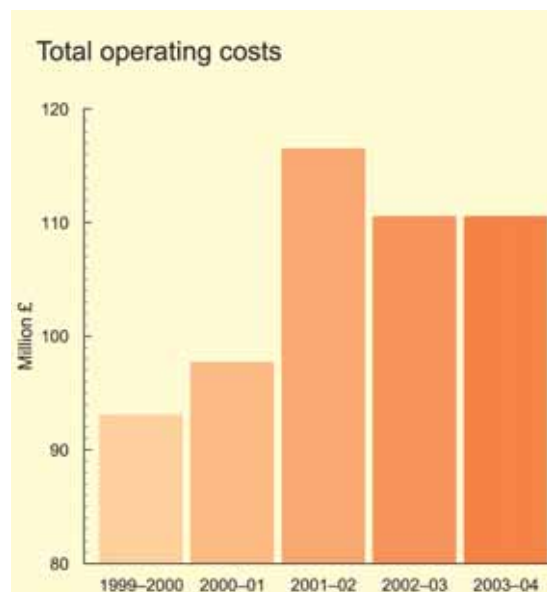
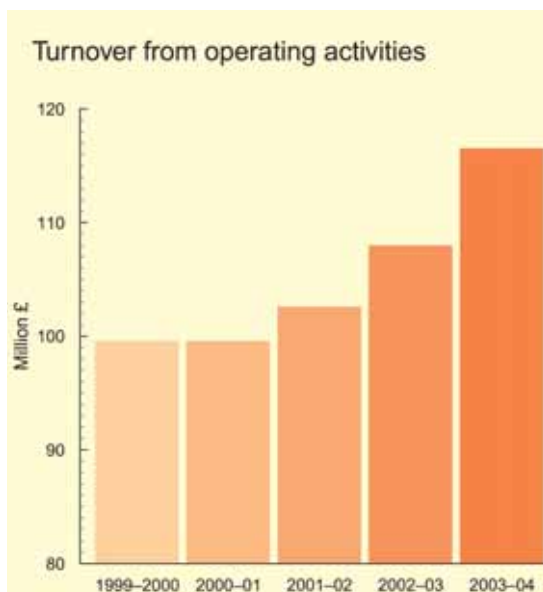
Trading revenue

Turnover from operating activities met management expectations, increasing by almost 8% to £116.3 million. Trading revenue accounts for most of this growth, increasing by £7.7 million to £101.6 million, reflecting strong growth in our customer base during the year. All market sectors saw growth over the previous year. Notably, 2003–04 was the first year of the Pan-government agreement, our contract to provide central government with core data products, which has provided access to our data to 204 departments and Executive Agencies. Revenue from our partners has grown by 15% over the previous year, the result of ongoing focus on our strategy to work alongside partners to bring the benefits of GI to new markets.

National Interest Mapping Services Agreement (NIMSA) revenue remained steady at £12.8 million (2002–03 – £12.5 million). Improvements in contractor productivity and internal efficiencies offset a significant increase in the rate of delivery of the Positional accuracy improvement (PAI) programme.

Operating costs

Total operating costs, at £110.6 million, were in line with last year (£110.6 million). Gross expenditure on wages and salaries was £49.3 million, a 7% reduction on 2002–03 (£52.9 million). This has

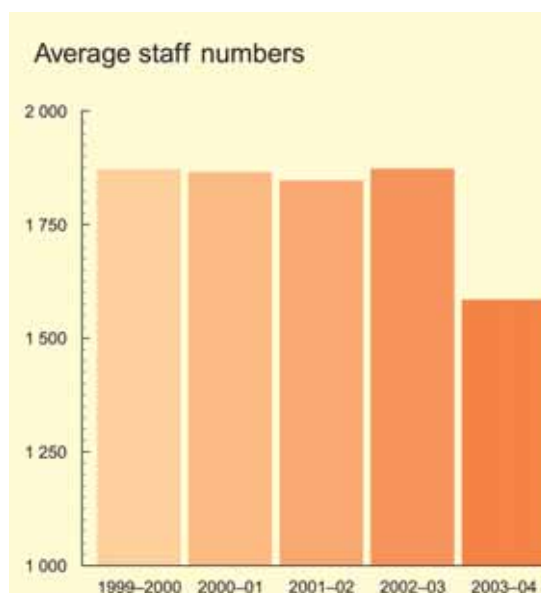


Operating results

	Year to 31 March 2004 £'000	Year to 31 March 2003 £'000
Turnover from operating activities	116 280	108 042
Surplus/(deficit) on ordinary activities before interest and exceptional item	5 582	(2 213)
Surplus/(deficit) for the year after interest and exceptional item	6 604	(39 359)
Investment programme	15 500	19 300

been achieved through a gradual reduction in staff numbers of 355 between February 2003 and April 2004, enabled by the voluntary release scheme noted in last year's report. The costs of this were provided for as an exceptional item in the year ended 31 March 2003. A further early release scheme was initiated during the year, which will result in the departure of 36 staff at a total cost of £2.6 million, which has been charged to staff costs within operating costs.

Other operating charges have remained flat at £44.4 million, despite significant increases in delivery rates for the Cyclic Revision programme (including PAI) and increased revenue. This reflects continuing success in controlling costs and improving the efficiency of the organisation through the development of new systems and emphasis on a more business-oriented culture, including a programme to help all staff understand and focus on customer needs. Improved quality of financial management and systems is enabling better attention to achieving value in all processes. Operating costs include the non-capitalised element of the investment programme (see below), which has reduced over the previous year by £3.2 million to £8.8 million.



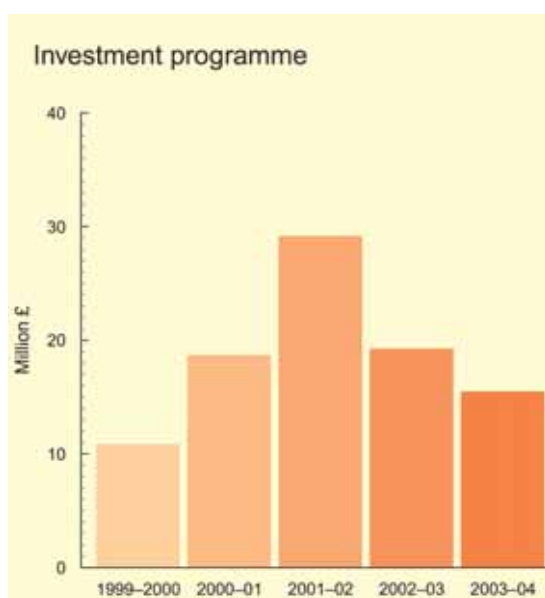
Results for the year

The results for the year show a surplus of £5.6 million before interest (2002-03 – a deficit of £2.2 million before the exceptional item). This return to profit ensured that Ordnance Survey achieved its financial objective of an average annual ROCE of at least 9% in the period 1 April 1999 to 31 March 2004.

Our joint venture, Point X[®] Limited, which is developing a points of interest database, has achieved significant progress during the year with an improved product achieving significant sales in the final quarter.

Investment programme

Total expenditure on investment activities was £15.5 million (2002–03 – £19.3 million). The definition of investment expenditure is an internal convention to include the project-oriented delivery of key change programmes, whether or not of a capital nature. Certain significant items of work, including the Cyclic Revision programme and data quality improvements, have been reclassified from investments to running costs due to their recurring nature. The figure quoted for 2002–03 investment expenditure in last year's Annual Report was £29.8 million. On a similar basis, the figure for 2003–04 would have been £28.6 million.



The total expenditure of £15.5 million includes £6.7 million capital (2002–03 – £7.3 million), principally investment in a new seamless database management system that is projected to be implemented in 2006–07. Expenditure on this system is recorded as an asset in the course of construction. The overall depreciation charge for the year is £8.4 million (2002–03 – £8.6 million).

The investment programme will continue to be led by the development of the database system for the next few years, although significant expenditure will also be directed at enhancing IT infrastructure and continuing to develop new and improved products, particularly layers of OS MasterMap. In addition, we are investigating options for rationalising head office accommodation as the costs associated with the size and nature of the current facilities are not appropriate for the present and projected future operations of Ordnance Survey.

Working capital

The cash balance at 31 March 2004 was £24 million (31 March 2003 – £28.7 million), the reduction being principally due to the payment of amounts due in respect of liabilities under early release schemes and capital expenditure offsetting cash inflows from operating activities. Overall, net current assets have increased in the year by £3.2 million to £16.2 million. Overall liquidity is projected to reduce over the next few years, with the investment programme and the early release scheme liabilities requiring substantial funding.

Capital and reserves

The increase in the General Reserve of £6.8 million results in a closing positive balance of £2.9 million and largely reflects the operating surplus for the year plus interest receivable. Asset revaluations, principally land and property (including investment property), and adjustments have resulted in an increase in revaluation reserves of £2.1 million. Total capital and reserves have increased by £8 million to £41.7 million as at 31 March 2004. During the year Ordnance Survey made scheduled loan repayments of £1.1 million (2002–03 – £1.3 million).

Control environment

Ordnance Survey continues to strengthen its control environment, seeking continuous improvement in accountabilities, processes and systems, and enhancing management reporting, including scorecards for risk and performance, which are reviewed monthly by Strategy Board. A key focus over the last year has been an emphasis on maximising the value received from resources expended and continuing to improve the quality of decision making.

The value of the business

In common with many other businesses, Ordnance Survey recognises that its financial statements fail to adequately represent the underlying value of the organisation, notably recognition of its intangible assets. Ordnance Survey possesses two principle intangible assets: the Ordnance Survey brand, and the data held in the geospatial databases. Neither are reflected in the balance sheet, but we encourage the reader of our financial statements to take these assets into account when seeking to understand the true value of Ordnance Survey's business, and to recognise that these assets are crucial to the successful delivery of future growth.

The accounting treatment of these intangible assets has been discussed in previous years' Report and Accounts. The treatment of the brand is clear – Financial Reporting Standard 10 (FRS10) prohibits the capitalisation of internally generated brands. The treatment of the data asset is less clear, but having taken professional advice, Ordnance Survey considers that the data is akin to intellectual property and as such is an intangible asset. Under FRS10, internally generated fixed assets are only capitalised where there is a readily ascertainable market value evidenced by an active market in similar assets. As our data is unique and has never changed hands, we consider that no value could be attached to it in the financial statements. Instead, ongoing costs of maintaining the data have been charged to the operating account as incurred and its accounting treatment and importance as an intangible asset disclosed by way of a note.

Our auditor, the Comptroller and Auditor General of the National Audit Office (NAO), has qualified his opinion each year since 1999–2000. NAO argues that the data comprises an accurate representation of a physical reality that is not affected by opinion, taste, judgement, reputation or belief and therefore differs from other intangible assets such as brands, and should therefore be capitalised in accordance with FRS15. Furthermore, NAO considers the data to be analogous to internally generated software, which, when used in conjunction with database management systems and associated

hardware (both of which Ordnance Survey does capitalise), is of continuing use in the business and supports the generation of future benefits. In the opinion of NAO, it is therefore inappropriate to capitalise the database management system and hardware without also recognising the value of the data itself. In a report prepared during 2000–01, NAO assessed the various methods of calculating a value for the data, proposing a value of not less than £50 million on the basis of future income generation.

There has been no material change in Ordnance Survey's position since the creation of the Trading Fund in 1999, and we continue to disagree with NAO over the accounting treatment of the data. This issue is an example of the international debate over reporting intangibles. Ordnance Survey continues to monitor developments, particularly forthcoming International Accounting Standards, and in the meantime urges readers of our financial statements to take account of the intangible value of both the geospatial data and the Ordnance Survey brand.

Outlook

As planned, Ordnance Survey has returned to profit this year and plans to remain profitable over the next three years. The financial year 2004–05 sees the introduction of a revised ROCE target of 5.5% for the next three-year period – a reduction in line with other Trading Funds and reflecting lower underlying interest rates than when the previous five-year target was set. The year 2004–05 will also be the first year for which Ordnance Survey expects to pay a dividend to Government, our sole shareholder. Unlike 2003–04, we are not expecting significant growth in revenue during 2004–05 as projected further increased revenue in our partner channels will be offset by the impact of the profiling of major contracts for direct data licensing. The next three years will be characterised by significant investment in infrastructure, particularly development of the replacement geospatial database management system, product quality and content, and head office accommodation.

Alastair Matthews
Finance Director