

MILK DEVELOPMENT COUNCIL
ANNUAL REPORT and ACCOUNTS
YEAR ENDED 31 MARCH 2006

Presented to Parliament pursuant to section 7 of the
Industrial Organisation and Development Act 1947 as amended by the
Government Resources and Accounts Act 2000 (Audit of Public Bodies) Order 2003.

Ordered by the House of Commons to be printed on 7 November 2006

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MILK DEVELOPMENT COUNCIL

OUR MISSION

To create the opportunities, insights and expertise to spur dairy farmers to improve their profits in a changing world

OUR VISION

Increased demand for milk supplied by profitable British dairy farmers

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CHAIRMAN'S REPORT

A year of positive progress

I am pleased to say that the MDC has had a very successful year furthering the objectives set by the Council. These objectives require action to develop the market for milk and dairy products, carry out research, communicate information that encourages milk producers to examine the efficiency of their enterprises, and the provision of market and industry information to aid the business decision making process.

Increasing dairy consumption

Happily, the market for fresh milk, after many years of decline, continued to grow during the year and the sales of other fresh dairy products showed positive growth. The MDC is working with many industry partners to ensure that this upward trend continues.

The encouragement of milk and dairy product consumption by young people is of paramount importance to the future of the industry. With this in mind the MDC has, with others in the industry, continued to promote the consumption of milk in schools. The consumption of dairy products by teenage girls is recognised to be of special importance to their long term well-being so this is currently being addressed by a targeted and highly appropriate 'teen girls' advertising campaign.

Targeted market development is proving a successful strategy to stimulate increased consumption. This is clearly demonstrated in the cheese sector where the sales of territorial cheeses, especially Cheshire and West Country cheddar, are recording increasing growth

Applying research to practical farming

The commissioning of research and the evaluation of other research carried out around the world remains a fundamental function of MDC to maintain Britain's dairy industry at the forefront of international best practice. To make use of this research, the MDC Regional Extension team has developed an efficient network with dairy companies and co-operatives to service discussion groups, and organise regional meetings to provide the link between research and the practical needs of the dairy farmer.

The quest for ever greater on-farm efficiency continues to be driven by an ultra competitive market which in turn requires the MDC to provide up-to-date information on improvements in breeding, feeding and general farm management, and to ensure that this information can be used on farms.

Decision making information for the industry

The MDC Datum information service has continued to develop its worldwide reputation for the provision of dairy market information which is widely used to aid decision making throughout the industry.

However, the more in-depth economic studies carried out during the year on dairy supply chain margin development, and the structure of the contracts being used within the industry have an equal importance to provide greater understanding and to stimulate change.

Levy board review

Throughout the year the Council has been working closely with the government and the other levy funded Non-Departmental Public Bodies as part of the review of the services provided from agricultural levies. The MDC continues to believe that the objectives it has set to support the industry are essential for the long term development of British dairying.

Financial Summary

During the year the levy of 0.06ppl provided income of £7,248k (2005:£7,278k). Additional income was obtained from a European Union (EU) grant of £750k (2005: £188k) towards the "teenage girls" campaign, and a grant from our sponsoring department (Defra) of £46k (2005: nil) where the MDC is working in partnership with the department on a project towards Business Improvement in the Dairy Sector. Interest of £135k (2005: £145k), and other income of £227k (2005: £73k) were also received. After administrative costs of £1,498k (2005: £1,208k), grants and project expenditure of £7,134k (2005: £6,577k), and allowing for our share in associated companies, taxation and minority interests resulting in a deficit of £69k (2005: a surplus of £19k), there was a total deficit of income over expenditure of £273k (2005: a total deficit of £2k).

Total reserves, inclusive of associate and subsidiary companies, at £3,051k (2005: £3,401k) have been maintained at a level commensurate with future spending targets, and above the minimum level required so that there will be no recourse to public funds.

Acknowledgements

I would like to place on record my sincere thanks to the Council for their support and input into providing the strategy for a successful year, and I would equally thank our Chief Executive and his team for delivering the success.

A handwritten signature in black ink, appearing to read 'Brian Peacock', written in a cursive style.

Brian Peacock
19 October 2006

CHIEF EXECUTIVE'S REPORT

The Council has set the mission of the Milk Development Council to “create opportunities, insights and expertise that spur Great Britain’s dairy farmers to improve their profits in a changing world”.

To achieve this, the MDC provides services aimed at improving dairy farmers’ ability to make profits. These services comprise:

- **MARKET DEVELOPMENT** leading to **opportunities** that can add value to, differentiate and increase demand for (or arrest the decline in demand for) raw milk.
- **FARM MANAGEMENT** providing Research and Development together with extension activities aimed at enhancing milk production **efficiency**, expertise and business-focus.
- **BREEDING+** services aimed at improving the genetic merit of dairy cattle, provided through our subsidiary organisation MDC Evaluations Ltd, operated together with United Dairy Farmers of Northern Ireland.
- **ECONOMICS** including a market information service aimed at providing **insight**, knowledge and research to aid better policy and investment decisions by dairy farmers through a period of intense market change caused by the reform of the Common Agricultural Policy and liberalisation of trade in dairy products.
- **NUTRITION** services, provided by the Dairy Council, which is jointly owned by MDC Holdings and Dairy UK, are aimed at providing consumers with accurate and independent information regarding milk and milk products.

Success in the provision of these services will mean increased demand for milk supplied by profitable dairy farmers in Great Britain.

Market Development

There have been five major areas of activity in the year including: creating positive demand; focusing on under 16 year olds; adding value to milk and milk products; enhancing availability; and this work is supported by our market and scientific research activity which will provide the basis for current and future campaigns.

Create Positive Demand

Our work in creating positive demand aimed at reversing the decline in demand for liquid milk, and increasing the demand for other products, has centred around two key campaigns. Independent analysis has shown that the Milk Moustache campaign operated in conjunction with the Scottish Dairy Marketing Company has led to an uplift in sales of liquid milk of 3.5% in the region covered by the campaign, compared with a 1% uplift in demand seen in other regions. The campaign continues to work with the Scottish Healthy Living initiative and has been successful at attracting additional funds from the European Commission.

The second major piece of work in the creating positive demand area of activity has been a campaign targeted at teenage girls, with the objective of reducing the occurrence of osteoporosis in later life. At the end of the first year of activity it is too soon to comment on consumption trends among the target group, however initial review work suggests a strong attitudinal shift, particularly in younger teenagers, which would normally be seen as a precursor to consumption change.

Focus on Under 16 year olds

During the year, work has continued with our team of 14 school milk facilitators – who are match funded by the processing sector – to establish school milk schemes in nurseries and primary schools across Great Britain. During the year a further 687 schemes were established bringing the total to 2,272 new schemes since the project commenced in 2002.

To support this work the MDC offers a number of educational packages to schools. These have been enhanced during the year by the introduction of a new web-based resource www.foodforlife.com which has been developed in conjunction with levy bodies from other sectors, and a new pack, entitled Health-Related Fitness, linking nutrition and sport, and launched in conjunction with Dairy UK with additional funding from the EU.

Work has also continued with the installation of School Milk Bars in secondary schools in partnership with First Milk, bringing the total number of bars in existence to 1,360. However, increased awareness of the need for good nutrition in schools and recent government initiatives have created further opportunities to develop this important opportunity with the consumers of the future. Because of this, the Council has commissioned research work to confirm the value of school milk provision, and is working with its partners to further develop this area of work in such areas as vending.

Adding Value

Work to increase the differentiation and value returned from the market place has continued during the year.

The MDC has published a report highlighting the potential of the dairy beverage market in Britain. The market size was shown to be £300m in 2004, and is growing at 39% per year.

Our work in the cheese market partnering the work of the British Cheese Board has helped to underpin an increase in cheese demand of 2.5%, while individual campaigns for regional cheeses have led to a 10% increase in demand for Cheshire Cheese, a 16% increase in demand for blended cheeses, a 20% increase in demand for West Country Farmhouse Cheddar, and a 2% increase in demand for Stilton.

Our work in the on-farm processing sector has seen the launch of materials, supported by case studies, aimed at helping milk producers seeking to enter the processing sector. Work in this area has seen three new products launched during the year, with development support for products already in the market.

Enhancing Availability

The MDC has commenced major market research work in the Food Service Sector, aimed at filling a void where dairy companies in the past have been unable to obtain reliable data in this growing sector of the market. This work is on-going and will report in the year ending March 2007.

Research and Support

During the year the Market Development team completed the largest consumer segmentation exercise carried out in the dairy sector for over 10 years. The information generated from this exercise is now being used at all levels within the industry to underpin the development of market strategies. In addition the Council has entered into an agreement with the University of Kent Business School to provide analysis of the Tesco's Clubcard data for the dairy sector, through the Dunhumby Academy.

Farm Management

The Council's Farm Management department aims to provide solutions to barriers to further efficiency through a programme of applied research and development activities. Not only this, it then applies the research to help dairy farmers manage their businesses to meet profit, legislative and market place challenges using a programme of extension and technology transfer techniques.

Research and Development

At the request of levy payers the research agenda has remained shorter-term, focusing on more 'here and now' issues at a time of intense market and legislative change. This has led to the output of many research projects culminating in the production of management tools such as 'parlour wizard', a tool aimed at optimising the investment in milk harvesting equipment.

Key projects delivered during the year have been: work identifying risk factors around mastitis which offers milk producers a potential 36% reduction in the disease; tools to review calving patterns to enable contractual supply needs to be met; reviewing heifer-rearing research in the UK and overseas; and recommendations regarding 'housing the 21st Century Cow'.

The MDC continues to work in conjunction with the other sector levy bodies on cross-cutting research issues through the Applied Research Forum.

Extension and Technology Transfer

The past year has seen a change in direction for the MDC field team. During the year the team has been successful in changing from arranging meetings for researchers to present their findings to milk producers, to facilitating meetings themselves. The business club/discussion group approach has been well rehearsed both in other sectors of UK agriculture and in other dairy industries around the world, and the MDC team is now successfully using these techniques to benefit milk producers in Great Britain.

Key to this change in direction has been the need to bring together producers who have common demands from the market. MDC has therefore entered into agreements with all the major milk buyers, several smaller buyers, and two retailers to establish business clubs of producers within their supply fields. During the year, 41 such groups were established, assisted in the co-operative sector by the award of a £386k grant from Defra.

For those groups which have already progressed to a stage in advance of the benchmarking tools provided by MilkBench, operated in co-operation with the Welsh Assembly Government and the Scottish Executive, a new scenario planning tool, the 'What if?' model has been introduced from Australia and adapted for the UK market.

The extension services have been supplemented during the year by the launch of the first dairy monitor farm operated in co-operation with Quality Meat Scotland.

Breeding +

Publication of genetic information on the bull and cow population of the UK is carried out by MDC Evaluations Ltd, which is jointly owned by MDC Holdings Ltd and United Dairy Farmers of Northern Ireland.

During the year MDC Evaluations completed its transfer of the operational work concerned with evaluating the genetic merit of UK dairy cattle to Edinburgh where the work is now carried out by a consortium comprising the Scottish Agricultural College, Edinburgh University and the Roslin Institute. This transfer saw the launch of an entirely new system of evaluation based on the data recorded on farm at individual tests rather than using aggregated lactation data. Initial problems concerning the international comparability of the data were quickly overcome and the new system has now become a trusted source of information.

Genetic gain will only be achieved if complex information is understood and acted upon. To aid this process the MDC has launched a programme aimed at assisting farmers to maximize their benefit from cattle breeding. In the three months following its launch, the *breeding+* programme has attracted 1,471 members.

Economics and Datum

The MDC operates a widely used market information service providing transparency and information to assist farmers (and their representatives) in understanding the market place. With this greater understanding they are better able to make changes to meet the pressures placed upon their businesses by future and current reforms of the Common Agricultural Policy and World Trade Organisation agreements. In addition, the team of economists carry out research work to help ensure that policy makers have fair and correct information on which to base decisions.

The demand for market information continued to grow throughout the year with over 330,000 downloaded files from the Datum website, and 70,000 fortnightly updates circulated, supplemented by a further 7,500 requests for research reports.

In the Autumn of 2005 the Council ran a series of 24 roadshows across Great Britain debating the effects that liberalisation of world trade would have on the sector, and encouraging producers to plan for the ensuing changes.

As a result of discussions with the NFU, leading to the publication of its "Vision for the Dairy Sector", the MDC researched and published a key report entitled "Contracts and Relationships in the Dairy Supply Chain". This report examines the problems in the supply chain caused by outdated contracts and identifies principles which should be incorporated in any revisions to contracts. Following the publication of the report many milk buyers have indicated they are reviewing their contracts, and changes have already been announced by some companies and co-operatives.

During the past year work has commenced on two further pieces of work. The first will identify factors contributing to international competitiveness, to understand how competitive the country's dairy farmers would be in a further liberalised world or European market place. The second will provide a deeper understanding of competition issues in the dairy sector.

Nutrition

The MDC provides nutritional information and services through its associate organisation The Dairy Council, which is 50% owned in partnership with Dairy UK.

The Dairy Council has undergone considerable change in the past year, implementing a new board structure and completing its move to a new office in Covent Garden under the leadership of its new Director Judith Bryans. The Dairy Council is now set to continue and enhance its vital role of defending consumers from inaccurate and misleading information about milk and dairy products.

The Dairy Council is also responsible for the management of the MDC's research into Human Health and Nutrition, which in the past year has involved completion of work into Conjugated Linoleic Acids and continuation of work on the Milk in Sports project.

Communications

Finally the work of the Council would not be used or valued if the levy payers and other stakeholders were unaware of its programme of activities.

Much effort has been expended to improve the MDC's record in this area over the past year. This has included: enhancing the role of our network of regional committees, adding new committees in the North West of England and in East Anglia (areas previously not well covered); re-designing our quarterly newsletter; enhancing our presence at trade shows; and better targeting our approach to the media.

A recent independent research report involving 5% of all milk producers shows that this effort has paid off, with MDC now enjoying a position of being the second most-widely used source of information for producers, following the farming press.

Our Activities across the whole of Britain

Wales

The MDC continues to work with the Welsh Assembly in providing funds to joint activities under the Dairy Development Programme. Our Welsh Regional Committee works as a shared Committee with the Dairy Development Programme, both parties having the same aim of satisfying the current and future needs of Welsh milk producers.

The MDC has two Council members from Wales appointed by the Minister for Environment, Planning and the Countryside.

During the past year we have co-operated with the Welsh Dairy Strategy group in their preparation of a sector strategy providing resource and information to the process. Information about the Welsh Dairy Sector has been published and is updated regularly on the Welsh Section of the MDC Datum website www.mdcdatum.org.uk , and the Dairy Development Centre Website www.ddc-wales.co.uk.

The MDC continues to maintain links with both FUW and NFU Cymru, whose members form the majority of levy payers across Wales.

The MDC maintains close links with the Welsh Assembly and Assembly Members regarding School Milk. A review of the effectiveness of this important area of the Council's work is being carried out in Wales which will lead to a renewal of the action plan for Wales. The MDC continues to provide educational materials in the Welsh language which support the need for a balanced health diet that contains dairy products. The school milk initiative in Wales has added more than 120,000 new school milk drinkers in Wales to date.

MDC is working with the Welsh Assembly to provide the 'MilkBench' business benchmarking service to dairy farmers. The Service is operated from the Dairy Development Centre at Gelli Aur in Carmarthenshire.

Scotland

The MDC has two regional committees in Scotland which provide feedback, and guide the Council regarding the needs of farmers in the region.

The Minister for Environment and Rural Development has appointed a Council member from Scotland.

The MDC continues to work with a consortium of Scottish Milk processors, represented by the Scottish Dairy Marketing Company, to promote milk using the licensed 'Milk Moustache' campaign. The campaign, which has been accompanied by increases in demand for liquid milk of 3% in Scotland, has successfully attracted EU funding, allowing a reduction in the contribution from the MDC to £280k per year (£840k over three years).

The MDC has worked with the Scottish Executive communicating the importance of a healthy diet and lifestyle with 'Dance Revolution' events being run at six venues across Scotland.

Our Farm Management Team, working in conjunction with Quality Meat Scotland, has launched the first Dairy Monitor farm aimed at demonstrating the effects of innovation and best practice.

Following the transfer of the UK's genetic evaluation work to a consortium comprising the Scottish Agricultural College, Edinburgh University and the Roslin Institute, a new system of genetic evaluation has been implemented, and the service to the levy payer has been updated and consolidated.

Conclusion

In addition to a successful year, the team which makes up MDC has also coped well with the natural uncertainty created by the Government's review of levy bodies, and I am pleased to report that these additional pressures were absorbed without interruption to the provision and development of the services outlined above. My heartfelt thanks go to my management team and all staff for a successful year, and to the Council Members for their continued support and advice.



Kevin Bellamy
MDC Chief Executive and Accounting Officer
19 October 2006

COUNCIL MEMBERS' PROFILES

Brian Peacock is Chairman of the Milk Development Council. He is also Chairman of Milk Development Council Holdings Limited, and the Milk Quality Forum. Brian is also a director of The Dairy Council, and Shilton Investments Ltd. During the year ended 31 March 2006 Brian was also a director of Leatherhead International Limited, and Leatherhead Food International Limited. A graduate of Leeds University in biochemistry and bacteriology, he has wide technical, commercial and managerial experience in the dairy industry, initially with a family business and then with Associated Dairies, the Co-operative Wholesale Society, and Northern Foods Dairy Group where he was Technical Director.

Brian Peacock chairs the North West and North East Regional Committee of the MDC.

Michael Brearley manages the 2,800 acres of Roxholme Estates and is a director of E.A.Robertson Ltd. Michael Brearley is also a member of the Lincolnshire Valuation Tribunal, and a Forum member for Dairy Crest Direct.

Michael Brearley chairs the Finance Committee and Eastern Regional Committee of the MDC. He is a member of the Audit Committee, Human Resources Committee, and Market Development Committee.

William Campbell FRAgS is a dairy and livestock farmer in Ayrshire, and he is a member of the NFUS National Milk Committee. He was a Scottish representative at CEJA between 1992-98 and is a past Chairman of the NFUS Ayrshire Regional Board. William Campbell is currently a local director of First Milk, and he is also a member of the Scottish Milk Forum.

William Campbell chairs the Communications Committee, and is a member of the Economics and Datum Committee, and the Audit Committee. He also chairs both Scottish Regional Committees of the MDC.

Rosemary Collingborn is a dairy farmer in partnership with her husband in Wiltshire. She has been National Dairy Chairman of WFFU and Vice Chairman of WFFU Dairy Committee. She is currently the farming member of the Veterinary Products Committee and a Trustee and Council Member of the RSPCA.

Rosemary Collingborn is a member of the Market Development Committee, the Finance Committee, the Communications Committee and chairs the South West Regional Committee of the MDC.

Christian Fox ARAgS share farms an organic dairy farm in Wiltshire. Before becoming a farm manager, he worked in business and served in HM Forces. He is immediate past chairman of the Dairy Council, and was awarded a Nuffield scholarship in 2001.

Christian Fox is a member of the Market Development Committee, the Farm Management Committee, and the Human Resources Committee.

Ian Gordon is Chairman of Giract, an international business research and consultancy company working in food ingredients worldwide. He is also Chairman of Alpheco, an in-vessel composting system supplier. He read Chemistry at Oxford and then worked as a Guinness brewer, as Food Ingredients Director of Express Dairy, and as an international marketing consultant for Coopers & Lybrand. Ian Gordon is a Council Member of the Society of Dairy Technology, a Fellow of the Royal Society of Chemistry and a professional member of the Institute of Linguists, and Food Technology. He also farmed 120 acres in South Buckinghamshire in the 1980s.

Ian Gordon chairs the Market Development Committee and is a member of the Communications Committee.

David Homer is a tenant of a mixed arable and dairy farm in Wiltshire and a Nuffield scholar. David Homer has been the Vice Chairman of the Wessex Regional Committee of the Tenant Farmers' Association, Chairman of the Wiltshire Grassland Society, Vice-Chairman of the United Kingdom Dairy Association (UKDA), and Vice-Chairman of the UKDA Technical Committee. David is also a Director of University of Reading Farms, and a member of the Local Advisory Group for National Milk Records. He is also a Forum member of Dairy Crest Direct and a producer representative with Waitrose Select Farm Milk.

David Homer chairs the Economics and Datum Committee, and the West Midlands Regional Committee, and he is a member of the Finance Committee, and the Farm Management Committee.

Gwyn Jones ARAgS is a dairy farmer in West Sussex and a Nuffield scholar. He is currently the Chairman of the NFU Dairy Board, and a member of the NFU Governance Board, NFU Policy Board and an NFU Council member. Gwyn is also a main board director of Dairy UK. He is a past NFU County Chairman, Chairman of the West Sussex Grassland Society, and a past Chairman of the Ruminators Dairy Study Group.

Gwyn Jones chairs the Farm Management Committee, and the South East Regional Committee, and he is a member of the Economics and Datum Committee, and the Human Resources Committee.

Thomas Jones FRAgS is a dairy farmer from Anglesey. He has been Vice President and Deputy President of the Farmers Union of Wales, a non-executive director of Dairy Crest plc, and the North Wales member of the Milk Marketing Board. Thomas Jones is a graduate of the University of Wales in Agriculture and Agricultural Economics. He is on the Milk Panel of the Welsh Development Authority's Agri-Food Partnership.

Thomas Jones chairs the Audit Committee, and is a member of the Communications Committee, the Finance Committee, and the MDC Regional Committee for Wales.

Trevor Lloyd runs a family dairy on the west coast of Anglesey. He is Chairman of the Anglesey County NFU and a member of the NFU Cymru Milk Board. He is also a non-executive director of National Milk Records plc. Trevor Lloyd has a BSc Hons degree in Agriculture from Harper Adams Agricultural College. In recognition of his achievements at home since graduating and his plans for the future, Trevor was announced as 'Dairy Farmer of the Future 2002' – a national award sponsored by key organisations in the industry. Trevor is Chairman of Milk Development Council Evaluations Limited.

Trevor Lloyd is a member of the Farm Management Committee, the Economics and Datum Committee, and is a member of the Welsh Regional Committee.

Jonathan Vickers spent 25 years in the international oil and chemical businesses, including four years as Castrol's director for worldwide marketing and R&D. He now sits as a non-executive on the boards of a wide range of organisations, including a Connexions partnership, The Planning Inspectorate, The Fire Service College and Government Office for the South West.

Jonathan Vickers chairs the Human Resources Committee, and is a member of the Audit Committee, and the Market Development Committee of the MDC.

Chief Executive and Accounting Officer

Kevin Bellamy CDir MBA prior to his appointment in June 2001 was Technical Manager of the MDC, managing the Council's research portfolio, a position he had held since 1996. Kevin Bellamy was with the Milk Marketing Board for a period of eleven years where he was involved with Research and Development for Farm Services and Operations Management for National Milk Records. Later he became Financial Controller for one of the Milk Marketing Board's four divisions. Kevin Bellamy is also Managing Director of Milk Development Council Holdings Limited and Milk Development Council Evaluations Limited, Chairman of Promise Fertility Limited and a director of The Dairy Council. Kevin is also a member of the NFU National Dairy Board and has recently qualified as a Chartered Director.

OPERATING AND FINANCIAL REVIEW

Statutory background

The Milk Development Council (“the Council”) was created on 7 February 1995 by Statutory Instrument, the Milk Development Council Order 1995 (SI 1995/356), made under the Industrial Organisation and Development Act 1947. The accounts have been prepared in the form directed by the Department for Environment, Food and Rural Affairs with the approval of the Treasury, under Section 7 of the Industrial Organisation and Development Act 1947 and the directions made thereunder.

Principal activities and objectives

The main functions and aims of the Milk Development Council are set out in Schedule 1 of the above-mentioned Statutory Instrument. The MDC is funded by a statutory levy on all milk production in England, Scotland and Wales. The income generated by this levy is used to improve the competitiveness and profitability of British dairy farmers by the promotion or undertaking of scientific research and development in the fields of milk production and milk consumption. An Amendment to the Order in 2000 enabled Ministers to approve an increase in the levy in order that funds could be used to enhance the public image of milk.

The mission of the MDC is to create the opportunities, insights and expertise to spur dairy farmers to improve their profits in a changing world, and its vision is increased demand for milk supplied by profitable British dairy farmers.

The activities of the MDC enable investment to be made in projects that aim to help dairy farmers reduce and control costs, and to improve their returns from the market they serve. To achieve this MDC:

- collects the levy from all milk producers and from this income
- identifies and commissions R&D projects appropriate to the needs of the industry after taking into account similar work carried out by other organisations;
- communicates the results of these projects to the dairy farmer and encourages their uptake;
- undertakes market research into consumer tastes, and supports joint promotional assignments to influence the direction of the market place towards dairy products;
- collects market and pricing information and statistics on an independent basis, and disseminates these effectively and promptly to the industry;
- encourages communication along the supply chain to improve competitiveness and choice to the benefit of the producers and consumers.

The MDC has two subsidiary companies under its control, MDC Holdings Limited and MDC Evaluations Limited (MDCEL). MDC, representing the milk producers, has a participating interest in The Dairy Council through MDC Holdings Limited who holds a 50% share of this company with Dairy UK Limited, the latter organisation representing the manufacturers, processors and distributors. The results of these companies are consolidated in this Annual Report.

Financial Review of performance against targets for the year ended 31 March 2006

A Summary of the Financial Performance of the Group over the last four years is given below with the actual performance against key targets shown for the 2005-2006 year.

Years ended 31 March	Target 2006 £	Actual 2006 £	Actual 2005 £	Actual 2004 £	Actual 2003 £
Income and expenditure account					
Levy income	6,997,000	7,248,184	7,278,141	7,264,169	5,894,831
EU Grant income	562,000	750,000	188,000	–	–
Other income	10,000	272,300	72,993	7,180	15,460
Administrative costs	(1,443,000)	(1,498,682)	(1,208,333)	(1,527,024)	(1,283,959)
Grants and project expenditure	(7,582,000)	(7,134,046)	(6,577,326)	(4,806,931)	(3,995,960)
Share of Dairy Council associate	–	(38,140)	38,620		
Operating surplus/(deficit) before interest and exceptional income					
Interest receivable (net)	50,000	134,936	145,215	73,753	34,212
Exceptional income	–	23,783	80,000	–	386,828
Surplus/(deficit) before taxation					
Taxation & Minority Interests	(12,000)	(31,443)	(19,027)	(14,013)	(12,686)
Surplus/(deficit) retained					
Balance sheet					
Fixed assets	79,000	89,465	31,302	33,281	41,412
Investments in associate company	–	223,267	261,407		
Stocks	–	4,690	340	3,393	5,284
Debtors and initial funding for research projects	2,750,000	2,410,937	2,409,149	2,026,104	1,972,268
Cash	1,078,000	2,952,186	3,112,870	2,803,225	1,602,799
Current liabilities	(2,555,000)	(2,489,495)	(2,373,960)	(1,789,423)	(1,542,317)
Pension liability	–	(140,000)	(40,000)	–	–
Capital and reserves					
	1,352,000	3,051,050	3,401,108	3,076,580	2,079,446

The Milk Development Council commenced trading in March 1995.

Income

During the year ended 31 March 2006, the total operating income of the MDC including the two companies under its control, MDC Holdings Limited and MDC Evaluations Limited, was £8,270k (2005: £7,539k). This operational income was £701k above target.

Levy collection

Levy income of £7,248k compares to £7,278k collected in the year ended 31 March 2005, and reflects a full year's levy at 0.06 ppl. Levy income in the year was above target by £251k, mainly because of improved collection procedures. The MDC works closely with the Rural Payments Agency to ensure that full details of milk production in Great Britain are available to compare with levy collection. As a result, 100% of the potential 2005-06 levy has been collected (98.9% in 2004-05). Some of this collection refers to previous years where the MDC has pursued non-levy payers for arrears. In the interests of fairness to all levy-payers and in line with its statutory obligations, the MDC takes a robust stance on levy collection. Whereas the MDC will treat sympathetically any levy-payer who is in difficulties, action must continue to be taken against those producers who fail to pay the levy. This is done through a combination of warning letters and, as a last resort, court action.

Other income

There were significant incomes from other sources, the original target of £572k being exceeded by £450k. There was additional grant income taken to account in the year from the EU (£750k against a target of £562k), and an unbudgeted £46k from Defra for the partnership project on Business Improvement in the Dairy Sector. Further unplanned match-funding of £128k was received from external sources in the year ended 31 March 2006.

During the year exceptional income of £24k was received by MDC's associate company, MDC Evaluations Limited, representing the write back of a balance on a redundancy trust fund that is no longer required.

Administrative costs

Administrative costs were higher than target by £56k, and have increased over the year by £291k to £1,499k (2005: £1,208k). The position in 2005 was affected by the reversal of a £115k provision no longer required. The 2006 spend needs to be compared with that of 2004 when administrative costs were £1,517k. The costs have been restated to take account of the FRS17 requirements with regard to pension liabilities. In 2006 these amounted to £25k (2005: £15k). The Council is committed to seeking ways to keep administrative costs at a minimum necessary for the effective running of the MDC, and this is an area that will be closely monitored.

Spend on communications and public relations increased by £166k to £590k. This was above target by £47k. In 2006 the Council took a positive decision to place more emphasis on raising farmer awareness of MDC activities, and a number of initiatives have been launched promoting the information and assistance available from the MDC. This change of emphasis reflects a growing understanding within MDC that the main barrier to uptake of its services was no longer the quality or direction of the services, but simple awareness of them and MDC's core purpose.

An increased spending of £155k on communication project costs to £392k in 2006 (2005: £237k) covered a greatly increased profile at regional and national shows, a relaunch of the quarterly newsletter and other direct mail, an overhaul of procedures and branding to increase consistency and professionalism, with a greatly increased focus on media relations.

Direct Council costs have been held more-or-less at previous levels, £176k in 2006 (2005: £174k), and below budget by £7k.

Grants and project expenditure

Grants and project expenditure was below target by £448k. Farm Management and Genetics expenditure was £169k below the original target; Market Development expenditure was below target by £364k; and Datum/Economics exceeded target by £85k. Although there has been an improvement over previous years, difficulty is still being experienced in meeting targets, mainly in ensuring that projects are initiated at an early stage to prevent slippage of the programmes.

However, promotional and market development funding has again been increased to £4,145k compared to £3,592k in the previous year. This is in line with the preferred direction of spend, as indicated by levy payers. The total amount of funding provided by Farm Management for R&D projects at £1,038k has decreased over the previous year's total of £1,232k, in accordance with plans to change the emphasis to greater involvement in on-farm collaboration and communication. The provision of statistical information and the communication of new technology and market innovations by the Economics and Extension teams reflect this change of emphasis, with spending in these areas increasing to £1,148k for the year compared to £1,099k spent in 2005.

Organisational grants of £275k (2005: £275k) were made to the Dairy Council and £484k (2005: £450k) to MDC Evaluations (MDCEL). Other organisational funding amounted to £23k (2005: £19k). These areas of spend were in line with targets.

Interest income

Interest income at £135k was £10k lower than in 2005, and £85k higher than target. A positive cash flow resulted in a higher level of reserves throughout the year than planned and, as a consequence, higher interest was earned than originally anticipated.

Final year-end position

The net effect on the Consolidated Income and Expenditure Account for the year ended 31 March 2006 was a deficit of £273k (2005: a deficit of £2k). This has resulted in closing reserves, after taxation, of £3,051k at 31 March, 2006 compared to the closing position of £3,401k at 31 March, 2005. These substantial variances from target of £1,145k underspend, and £1,699k higher reserves leave the MDC in a healthy position. However, the Council is aware that grants and expenditure must be directed towards projects that will improve the position of the dairy farmer in meeting the challenges that lie ahead. The Council is determined that expenditure will only be applied when value for money can be justified.

Fixed assets

Expenditure on tangible fixed assets is set out in Note 13 to the Accounts. A total cost of £90,543 was spent on fixed assets acquired during the year. The major acquisition was £74,488 spent on an upgrade to the main operating system software because the IT provider was no longer prepared to support the earlier version. There were no other individual capital costs exceeding £5,000 in value during the year. The Council is of the opinion that there are no significant differences between current market values and book values of fixed assets.

The computer equipment and software necessary to continue the operations of MDC Holdings' subsidiary company, MDCEL, were transferred in 2005 to SAC Commercial Limited free of charge. At the termination of the contract with SAC Commercial Limited, MDCEL has the right to re-acquire at no cost any such original equipment as has been transferred. The remaining fixed assets, mainly furniture and fittings that had been fully written down in the books of account of MDCEL, were transferred at the same time to MDC free of charge.

Prepaid rent

The lease on the previous premises of the MDC expired in 2004 and alternative accommodation on the property of the landlords (Royal Agricultural College) was offered. This provided advantages to the MDC in being a self-contained unit with accommodation that could be made more suitable for an office environment. MDC met the immediate costs of converting the premises into offices in return for a discounted annual rent over a period of five years. The prepaid rent of £192,283 is being written off over this period, the balance remaining at the end of the year was £134,887.

Treasury management

The treasury operations of the MDC are managed within parameters formally defined and authorised by the Council to manage the financial risks that arise in relation to underlying business needs. The activities of the treasury function are routinely reported to the Audit Committee and are subject to review by internal and external audit. The function does not operate as a profit centre, and the undertaking of speculative transactions is not permitted.

The main financial risks faced by the MDC relate to the availability of funds to meet business needs, the risk of default by counterparties to linked project funding, and fluctuations in interest. These risks are managed by ensuring that there is an appropriate combination of retained reserves and, if required, short-term bank borrowing in order to achieve the objective of continuity of funding.

The lower net deficit than planned has resulted in a closing net cash balance as at the 31 March 2006 of £2,952k (2005: £3,113k), compared to a target of £1,078k. Balances are monitored daily to ensure that accounts are not left in overdraft. Any cash surpluses in current accounts are transferred automatically to high interest accounts to ensure a fair rate of return on levy payers' money. The policy on payment to suppliers continues to be payment on 30-day net terms, and this is operated as far as is possible.

Reserves

Reserves are needed to provide sufficient cover for future funding of projects, and to provide for staff redundancy and other costs in the event of the MDC being wound up so that no costs fall to the public purse. The Council has determined that the general reserve should not fall below £500k. This is considered sufficient to cover a close down situation. The MDC has also set aside sufficient funds in a separate Market Development Reserve Fund to stimulate markets that add value to milk and dairy products. The total reserves of £3,051k (2005: £3,401k), therefore, comprise £1,391k (2005: £1,568k) in the Market Development Reserve Fund, and £1,657k (2005: £1,834k) in the general retained surplus. A small balance of £2,841 (2005: a deficit of £209) relates to the minority interest in MDCEL.

Five year summary

During the last five years the total levy income has been £34m and, of this, the amount spent on Grants and Project Expenditure, inclusive of promotional campaigns, has been £27m. The proportion of income expended on Grants, Projects and Promotional work, therefore, stands at 79%.

Normal administrative costs have risen over recent years, but the Council continues to keep these costs under review. The administrative costs for 2005-06 at £1.5m compares with £1.2m in 1999, before the relocation to Cirencester. The proportion of income expended on administrative costs since moving offices is 18% compared to an average 23% over the five years prior to relocation.

The prudent approach over the last five years has allowed the MDC to maintain reserves at a consistent level that will enable the Council to utilise these funds to meet the expectations of its levy payers, and to meet any emergencies that may arise in the future.

Non-Financial Targets (Key Performance Indicators)

Market Development

MDC is actively encouraging the consumption of milk at an early age through its employment of school milk facilitators to set up school milk schemes in primary schools and to organise the establishment of milk bars in schools in collaboration with local dairies.

The department struggled to fill positions for its projected number of school milk facilitators during the year as the dairies – which co-fund the facilitators – were undergoing periods of uncertainty and change. As a result, the department restructured part way through the year and started to focus on converting all schools within supportive Local Education Authorities. The results were positive, with a significant increase in schools coming on board. The approach for the school milk bar initiative was also revised, with a reduction in the number of bars installed but a focus on installing them in more sustainable environments in supportive schools.

Against this backdrop, the results for the year were:

- a 20% increase in milk drinkers in existing schools as targeted;
- 687 new schools added against a target of 800;
- 25 new Local Education Authorities added against a target of 100;
- 360 new milk bars installed in secondary schools against a target of 500.

In line with the promotion of milk consumption, the MDC is also tackling the problem of public perception of milk. A target was set that 60% of people questioned should see milk as an important ingredient in their diet, based on previous studies that had indicated 54% currently viewed milk in the way. However, a major public perception study carried out in the course of the year actually showed that 70% viewed milk as important; thus the aim had already been exceeded.

The study also disproved the previous finding that 17% of the public knew the true fat content of semi-skimmed milk as the study showed this was in fact starting from a base of 7%. Thus the target of 22% was extremely ambitious, but there was an increase of 1% in those understanding the true fat content over the period of the year, to 8%. Similarly, the stated aim of 27% of people viewing milk as healthy rising to 32% was shown to be irrelevant as the new base from the study became 62%. This did rise to 70% in the year, thus exceeding the target in relative terms.

In other areas the MDC planned to help introduce one new dairy beverage to the market and five regional milks; in fact the MDC helped with one beverage and one regional milk.

In the cheese area, significant progress was made with an overall growth of 2.5%. This was aided by substantial growth in cheese which had been the focus of MDC campaigns – namely Cheshire (10% growth), Stilton (2%), Blended (13%) and West Country Farmhouse Cheddar (20%).

The targets set were particularly ambitious, and difficult to achieve. However, the MDC is committed to continuing its efforts to achieve a wider appreciation of the merits of dairy products, and it will also continue to set high standards of achievement in order to meet these aims.

Farm Management

One of the major targets for Farm Management was to relocate the Genetics function (MDC Evaluations Ltd) from Chippenham to Edinburgh, and to launch the new *breeding+* initiative. Although early teething problems were experienced, the new organisation rapidly settled down and is now an acknowledged presenter of accurate, independent Genetic information to the dairy farmer. The target membership of 500 for those signing up to the *breeding+* programme was well exceeded with actual membership standing at 1,471 at year end.

The number of producers aware of research and new technologies can be measured by the number of attendees at MDC meetings and events held during the year. There were 4,833 attendees at these events against a target of 3,000.

Success in the supply of technology transfer can also be measured by the number of groups formed by farmers in order to take advantage of the various initiatives launched by the MDC. In the year to March 2006, there were:

- 41 new discussion groups established against a target of 48;
- *grass+* secured 372 new members against a target of 500;
- *pd+* signed up 377 against a target of 500;
- the *K4K* programmes, which are being phased out following a decision made part way through the year, signed up a more manageable 55 groups against a target of 150;
- on the *Benchmarking* project there were 125 new registrations and a 30% return on rate of use compared to a target of 385 registrations and a 70% return on rate of use;
- the launch of the 'What If?' model took place in January 2006 slightly later than planned (September 2005); this was after extensive trials. Two successful courses have already been completed in March 2006.

Generally, there were mixed results in this area and thought has been given to the approach needed to encourage a greater take-up of initiatives that are of value to farmers, and a less ambitious approach to those that may only provide a marginal return.

Datum/Economics

The Market Information Service (Datum) is aimed at making producers more aware of the market place and the economic factors affecting their business. It has had a successful year, as demonstrated by the following achievement against targets:

- The number of information file downloads were 337,544 against a target of 200,000.
- There were 69,058 copies of the fortnightly Dairy Market Update provided free of charge through e-mail or fax against an original target of 70,000 copies.
- There were 7,459 people ordering reports against a target of 3,000.
- There were 2,874 enquiries about prices and markets against a target of 1,000.
- Datum information appeared in 325 press reports, slightly less than the 400 target (although a different measurement system was put in place after the target was set).
- There were 39 presentations to farmer meetings against a target of 50.

Communications

One of the main concerns was the lack of clear understanding by dairy farmers of the role of the MDC. The Council set a target that at least 75% of dairy farmers should be aware of the work performed by the company by the three-year period between 2005 and 2008. The latest information received indicates that 65% of dairy farmers understand the role of the MDC in the industry as of January 2006. This proves there has been a solid increase in awareness and the target for 2008 appears achievable.

In its aim to communicate the results of research and obtain feed-back from the dairy farmer the MDC has established a number of regional committees around Great Britain. Participation by dairy farmers in these committees is purely voluntary, and the aim was to achieve 90% participation for the positions available by 2008. In the year, participation was 77% but it continues to rise and the target is expected to be reached by 2007.

The Communications function was also set targets for potential coverage in farming journals, and in national and regional consumer press during the year. This was a little known area of measurement, and the original targets of 2.5 million circulation were well exceeded with actual figures showing over 50 million circulation.

Main trend assumptions in the market place and their likely impact

It is assumed that the process of market reform and liberalisation will continue to impact the European dairy sector for the foreseeable future. Common Agricultural Policy reforms taking place through to 2008, and probable further reforms after that date are likely to reduce the floor in the markets. The potential future WTO agreement freeing up trade in agricultural commodities, for which modalities are due to be agreed by the end of July 2006, will increase competition in European markets by reducing export support and allowing increased imports. The net effect of these changes is likely to be the continued erosion of commodity milk product prices, in turn leading to a downward pressure on farmgate prices. This downward pressure on price is likely to lead to continuing re-structuring of the production sector with fewer operators and increased herd sizes. MDC will continue to assist throughout this period of intense market change by providing technology to reduce production costs, and marketing activities aimed at differentiating milk from the pool of milk supplied for manufacture of commodity products, while providing clear information throughout the sector on the effects the changes are having.

Future trends and directions of the MDC

The MDC has refreshed its corporate plan for the years 2006 to 2009.

Under the plan the MDC will continue to focus on four key areas of developing the market for milk and dairy products: creating positive demand, focusing on under 16 year olds, adding value, and improving availability.

Our Economics and Market Information team will provide transparency and information to dairy farmers to build their potential to exploit the market. They will also provide services and information aimed at helping dairy supply chains to operate more efficiently, and to ensure that policy makers are well informed in making decisions affecting the sector.

Our Farm Management team will help dairy farm businesses meet the legislative and profit challenges through market led activities that will deliver effective tools, based on research, for farms. This will be increasingly through the use of supply chain based business clubs facilitated by the MDC's field extension force.

In conjunction with the Farm Management Team, the MDC will continue to enhance the information supplied to milk producers under our '*Breeding+*' services quantifying the genetic merit of the stock which they own, providing the possibility of maximising genetic progress of both economic and welfare traits.

Finally, the MDC will renew its commitment to the communication and provision of services to dairy farmers in line with its public body status to ensure maximum integrity, transparency and accountability.

Key strengths and resources of the MDC

The key strength of MDC lies within its staff and knowledge base. The development of the organisation, since its establishment in 2005, has built a substantial databank of information from production research, through market and economic information to consumer information and trends. Such data continues to be built through a combination of research and market contracts, and personal contact by MDC staff across the sector. In parallel, the MDC has developed a core team of staff with significant expertise within the dairy sector, who are qualified within their specific areas of expertise, and continue to receive training and development in line with the organisation's Human Resources policy. Finally, the MDC operates with the benefit of receiving most of its funds from a statutory levy. This allows funds to be applied in a way which increases the competitive position of dairy farmers unencumbered by normal commercial restrictions.

Contingent liability

The Milk Pension Fund, referred to in note 25, continues to give concern. In previous years the MDC has reported on the necessity of meeting substantial increases in employers' contributions in order to provide stability to this fund. The MDC has only two active members in the Fund, and the MDC bears a disproportionate cost in meeting its obligations to the Fund. The Council has taken advice and sought the views of the Treasury on the best course of action in order to minimise any future impact on the MDC, particularly since there are certain classes of deferred pensioners for whom the MDC could potentially become liable. A contingent liability of £1.4 million has been agreed by the Council to be used, if negotiations are successful, in order to eliminate this risk and settle all future obligations of the MDC to the Milk Pension Fund.

Charitable donations

No charitable donations, other than grants made in furtherance of the objectives of the MDC to bodies that may have charitable status, have been made during the past year.

Citizens' Charter

The MDC adheres to the principles and standards of service as established by central government in its document *Service First, the new Charter Programme*. The MDC has a Citizens' Charter and Statement of Service Standards available to the public that demonstrates how the services are provided in accordance with these principles. The activities and major performance targets for the MDC in the year 2005-2006 have been achieved in that it has undertaken to:

- provide relevant services for the dairy farmer;
- provide information that is independent of commercial influence;
- deliver services by the most appropriate and cost effective communication channels;
- respond promptly to all requests for information within 10 working days.

The Code of Practice on Access to Government information applies directly to the MDC. The MDC has its own policy of visibility and transparency established in a Code of Openness, and it seeks to make available all relevant information in a clear and easy to read format. The activities of the MDC are kept under constant review with the aim to improve the services and operate more cost effectively. The MDC is committed to working with others and is always looking for ways of sharing resources and eliminating unnecessary duplication.

Freedom of Information Act 2000

The MDC is bound by the terms of the Freedom of Information Act and has produced a Publication Scheme that has been accepted by the Information Commissioner. The Scheme and related documents are posted on the MDC's website (www.mdc.org.uk). Over the year there were no queries concerning the MDC's role in collecting the levy. There were four requests for information contained within the MDC. All queries were answered within four days.

Open Government

MDC embraces the principles of Open Government and seeks to communicate its activities through the publication of its annual corporate plan, and the posting of the agendas and minutes of the Council and its committees on the MDC website.

Payment Practice policy

The MDC policy in relation to research and project payments is that settlement should be made within the contractual terms as agreed, and subject to the satisfactory completion and acceptance by the MDC of work undertaken at predetermined stages of the project. The policy on payment to normal commercial suppliers is in accordance the government's Better Payment Practice policy. Normal settlement is made on 30-day net terms from the date of receipt of invoice. As at 31 March 2006 the Council's level of "creditor days" for normal commercial suppliers amounted to 19 days (2005: 20 days). There were no payments of interest relating to the Late Payment of Commercial Debts (Interest) Act 1998.

Environmental policy

The Milk Development Council is totally committed to minimising any harmful effects of its activities on the environment and to working with suppliers, levy payers and the local community to carry out this policy. Procedures to reduce energy usage and minimise waste have been put into place and the Council works with suppliers to avoid excess packaging and to promote the use of recyclable materials.

Corporate social responsibility

The MDC has an obligation to act in a manner that is acceptable to its range of stakeholders. To further this objective the MDC has embraced the aims of its sponsoring department, Defra, in encouraging the sustainable development of the dairy industry to achieve a better quality of life for everyone including:

- a better environment and sustainable use of natural resources;
- economic prosperity through sustainable farming that meets consumers' demands;
- support for thriving economies and communities in rural areas.

Council members

The members of the Council who have served during the past year are set out on page 58. Profiles of the current members of the Council are given on pages 10 to 11.

Council members' responsibilities

Council members have corporate responsibility for ensuring that the MDC complies with any statutory or administrative requirements for the use of public funds. Members are responsible for the overall strategic direction of the MDC within the terms of the above-mentioned Statutory Order, and for ensuring that high standards of corporate governance are observed at all times. Council members, whether full or part-time, are expected not to occupy paid political party posts or hold particularly sensitive or high-profile unpaid roles in a political party. The Council has drawn up rules of conduct for Council members which expect members to declare any personal or business interests that may conflict with their responsibilities as Council members. The Council has established a Register of Interests of Council members which is open for public inspection at the Council's offices. The register includes all members' commercial interests in the dairy industry and research community, together with relevant consultancies, trusteeships and committee memberships. At no time during the year did any Council member have any interest in any material contract with the MDC.

Corporate Governance

The Council has established seven committees to review progress and advise on strategy, and to ensure that the organisation conducts its affairs in a transparent and accountable fashion. Committee members are drawn from Council members and are appointed on an annual basis, with a maximum membership being set at five for each committee, quorums of three being necessary to conduct business and regular meetings taking place during the year.

Two committees are in place whose roles are more closely defined by existing legislation: the Audit Committee and the Human Resources Committee.

Audit Committee

The Audit Committee is responsible for advising the Council and Chief Executive on risk, control and governance matters, including internal and external audit of the MDC. Its responsibilities include the specific duty to review both management procedures for monitoring the effectiveness of the systems of accounting and internal control, and the Accounting Officer's Statement on Internal Control before endorsement by the full Council of the MDC. The Audit Committee has a primary responsibility for advising on the major business risks, and the appropriate strategies taken by management to manage these risks. It meets at least four times a year, in addition to at least one meeting with the external auditors at which no member of the executive management team is present.

Human Resources Committee (see Remuneration Report on page 23).

Finance Committee

The Finance Committee has the delegated authority from the Council to:

- scrutinise levy collection;
- agree finance and facilities policy;
- oversee procurement;
- review overall financial performance; and
- review the reserves position.

There are four other committees which have been delegated authority from the Council to:

- advise on strategy and budget proposals; and
- scrutinise performance against plans.

These are Market Development, Farm Management, Economics & Datum, and Communications.

Disabled employees

MDC gives every consideration to applications for employment from disabled persons. Disabled employees and those who become disabled during their employment are employed under normal terms and conditions wherever possible, and are provided with training and career development opportunities using selection criteria common to all employees.

MDC has ensured that its new premises conform to the requirements of the Disability Act. On moving to the premises a Disability Audit was commissioned and recommendations made to improve matters further than required by the Act have been implemented.

Employment policies

The Milk Development Council depends on the skills and commitment of its employees in order to achieve its objectives. Staff are, therefore, encouraged to make their fullest possible contribution to the success of the MDC. The company's employment practices are designed to attract, retain and motivate all employees and to encourage their participation within the business.

Employment legislation is continually monitored to ensure that MDC's policies and procedures comply with any new developments.

MDC is an equal opportunity employer. The Council's selection, training, development and promotion policies ensure equal opportunities for all employees regardless of gender, sexual orientation or marital status, race, religion, or age. All applicants, including disabled persons, are given full and fair consideration and are judged on the merits of their qualifications and experience in relation to the particular demands of the post.

MDC seeks to promote and maintain good relations with its staff and considerable emphasis is placed on the development and maintenance of an open management style with frequent and informal consultation at a working level. On a more formal basis, regular staff meetings are held to discuss matters of general concern.

MDC ensures the regular provision of information on the company's performance to its employees through frequent reports.

MDC supplements staff by means of consultants in order to meet specialised and short term requirements for personnel.

MDC has indemnity insurance arrangements for Board members and all other employees and consultants.

Pension liabilities

The MDC contributes to a defined contribution pension scheme and a defined benefit pension scheme. For the year ended 31 March 2006 the MDC has adopted the requirements of FRS17 "*Retirement Benefits*". The Notes to the Accounts contain details of the accounting treatment (Note 1), details of costs (Note 9), and pension commitments (Note 25). A contingent liability, as described above, has been recognised for a potential liability that may arise with respect to the Milk Pension Fund. The adoption of FRS17 constitutes a change of accounting policy.

Health and safety

The MDC continues to observe the regulations made under the Health and Safety at Work, etc. Act 1974 in the working environment, and the standards required are subject to regular review as part of the process of safeguarding the well being of employees. On moving to the new premises a detailed health and safety review was conducted, responsibility for health and safety was assigned to area safety officers, and all staff were provided with guidance on procedures to be followed in the event of an emergency. During the year the premises have been subject to a risk assessment by the Fire Service and there were no major issues of concern. There was one reportable accident on the premises during the year ended 31 March 2006. However, no blame was attached to the company or its employees arising from this incident.

Review of Levy Bodies

A "Review of Agricultural and Horticultural Levy Bodies", commissioned by Defra, was published in November 2005 by Rosemary Radcliffe. The review concluded that "there continues to be a case in principle for a statutory levy in each of the product areas to which it currently applies". The report goes on to recommend improvements to the arrangements for governance and accountability, activities, arrangements with regards to the levy and the efficiency of service delivery. The Minister of State for Sustainable Farming and Food announced on 28 June 2006 that the five statutory agricultural and horticultural levy bodies would be restructured. The new structure would be in place by 1 April 2008.

The announcement confirms the need for continuation of statutory levies, for a review of services and for a new levy board structure. The existing five levy boards will be replaced by one overarching levy board which will be a Non-Departmental Public Body, and probably six separate sector specific companies limited by guarantee.

A Project Board has been set up to oversee the implementation process of this restructuring, comprising the chief executives of the boards and officials from Defra and the Devolved Administrations. The Project Board will provide overall direction to, and management of, the implementation of the levy board reform. It will be accountable for the overall success of the project and will work closely with the project implementation team in Defra to ensure that restructuring of the levy boards is completed on time and that issues arising are resolved.

There is also a Strategic Steering Group for the project, made of levy board chairmen, farming unions and other farmer representatives. The Strategic Steering Group will be responsible for strategic direction and policy development on a range of issues concerning the statutory levy arrangements. A further assessment of the business requirements will also be made (known as the "Fresh Start" initiative) to formulate decisions on which services should be provided by the central levy board to the sector companies on a shared basis.

Work has begun on drafting legislation to replace the existing levy boards with the new structure. The draft legislation is expected to be complete by early 2007 at which point there will be a full public consultation on the legislation.

Going concern

The MDC is subject to a periodic ministerial review of its activities to ascertain whether it is meeting the requirements of the Statutory Instrument. The last review took place during the 2002-2003 year. The review concluded that there was a clear case for the continuation of the MDC activities for a further five years.

The Council considers that the MDC has adequate resources to remain in operation for the foreseeable future and has, therefore, continued to adopt the going concern basis in preparing the financial statements.

Auditors

The Comptroller and Auditor General has been appointed the external auditor of MDC under The Government Resources and Accounts Act 2000 in respect of each financial year ending on or after 31 March 2004.

No payments have been made to the auditors for non-audit work during the year ended 31 March 2006 (2005: nil).

The Accounting Officer has taken steps as considered necessary to make himself aware of any relevant audit information and to make the auditors aware of that information, and so far as the Accounting Officer is aware, there is no relevant audit information of which the auditors are unaware.

The Operating and Financial Review has been prepared in accordance with the Accounting Standards Board's 2006 Reporting Statement.



Kevin Bellamy
Chief Executive and Accounting Officer
19 October 2006

REMUNERATION REPORT

Human Resources Committee

The Human Resources Committee performs inter alia the functions of a remuneration committee.

The Human Resources Committee comprises four Council members, as listed on page 58. The Committee is responsible for considering, and making recommendations to the Council on the base salary and benefits of the Chief Executive, and for determining, on the Council's behalf, specific remuneration packages and other employment benefits for each of the employees of the MDC. The Chief Executive attends meetings of the committee when it is considering the performance and remuneration of other members of staff.

Role of the Committee

- to advise the Council on human resources policies and procedures;
- to advise the Council on health and safety policy and practice;
- to recommend the salary and benefits of the chief executive to the Council;
- to determine salary structure for all other grades;
- to monitor staff pension arrangements;
- to monitor grade levels and appraisal procedures;
- to monitor training plans;
- to advise on succession planning.

Remuneration policy

Council members do not receive remuneration but can claim an honorarium of £150 per day for meetings attended, or for work carried out solely on the Council's behalf. The amount of the honorarium is determined by the Department for Environment, Food and Rural Affairs after consultation with other ministerial departments. No pension contributions are paid for Council members.

The Chairman's remuneration is linked to Senior Civil Service pay bands and is adjusted pro-rata to reflect the number of days actually spent on MDC work. The MDC is advised annually of the salary by the Department for Environment, Food and Rural Affairs.

Council members and the Chairman are entitled to claim expenses for work undertaken on behalf of the MDC. These are reimbursed at the same rate as that for employees of the MDC.

Details of remuneration, pension entitlements and benefits of the Chairman, Council members, and Chief Executive are set out below.

Chairman and council members

The emoluments of the Chairman were £34,849 (2005: £33,999). No pension contributions are paid for the Chairman.

The following honoraria payments have been made to Council members:

	Honoraria payments for the year ended:	
	31 March 2006	31 March 2005
	£	£
Michael Brearley	4,875	5,700
William Campbell	6,675	6,975
Rosemary Collingborn	6,600	6,825
Christian Fox	8,400	9,900
Ian Gordon	1,800	3,450
David Homer	8,025	9,150
Gwyn Jones	3,825	6,300
Thomas Jones	5,400	7,350
Trevor Lloyd	10,275	6,250
Jonathan Vickers	3,900	5,475

Chief executive

The gross emoluments of the Chief Executive (who is not a Council member) were £74,308 (2005: £70,690), plus a car allowance of £6,600 (2005: £6,600). The gross emoluments include provision of private health cover. Additionally, gross pension contributions were paid on behalf of the Chief Executive of £19,820 (2005: £19,443). The cash equivalent transfer value of the pension of the Chief Executive under a defined benefit pension scheme at 31 March 2006 was £51,375 (2005: £40,399). The accrued scale pension as at 31 March 2005 was £6,688 per annum, and as at 31 March 2006 the figure was £9,967 per annum. The accrued scale pension has, therefore, increased by £3,279 a year over the last twelve months.

The Chief Executive is employed under a service contract which entitles him to six months' notice of termination. There is no entitlement to any other benefits on termination of employment. Remuneration of the Chief Executive is decided annually by the Council on recommendations put forward by the Human Resources Committee.

Other employees

The number of employees, other than the Chief Executive, earning in excess of £40,000 (excluding pension contributions) is as follows:

	2006 No.	2005 No.
£60,000 and £64,999	1	1
£55,000 and £59,999	–	–
£50,000 and £54,999	1	–
£45,000 and £49,999	4	2
£40,000 and £44,999	–	2

Base salary and benefits for all employees of the MDC are reviewed annually by the Human Resources Committee. In reaching its decisions the committee is advised by an external human resources consultant. Annual appraisals are conducted with each employee to determine performance and areas where additional training is required. The base salary for each employee is determined by taking into account individual performance, and information from independent sources on the rates of salary for similar levels of responsibility in comparable organisations. A grading system is in operation and the duration of employee contracts is dependent upon the grade occupied. Senior management and staff are employed under service contracts of three months' notice of termination, all other staff are employed under contracts requiring one month's notice of termination. There is no entitlement to any other benefits on termination of employment.

In addition to salaries, the MDC provides private medical insurance after a year's service to employees in defined grades, and contributes to approved pension schemes for all employees who wish to join such schemes.



Kevin Bellamy
Chief Executive and Accounting Officer
19 October 2006

STATEMENT of Accounting Officer's responsibilities in respect of the Accounts

The Chief Executive, as the designated Accounting Officer, is required to keep proper accounts and prepare statements of account for each financial period which give a true and fair view of the state of affairs of the Council and of the surplus or deficit of income over expenditure, in such form as the Ministers, with the approval of the Treasury, may direct. In providing those accounts, the Accounting Officer is required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- prepare the accounts on the going concern basis, unless it is inappropriate to presume that the Council will continue in business.

The MDC Chairman, who works on a part-time basis, and the Council, composed entirely of non-executive members, are appointed by the Secretary of State for the Department for Environment, Food and Rural Affairs, the Scottish Ministers and the Minister for Rural Affairs, National Assembly for Wales. Council members and the Chairman are appointed for terms of three years, and are eligible for re-appointment; generally Council members can serve no more than two terms. In exceptional circumstances these terms may be extended, and the present Chairman and Council are in such a position where they have been requested to remain in office until 31 March 2008, when the new levy board structure will be put in place (see Review of Levy Boards, page 21). Remuneration for Council members and Chairman is approved by the Secretaries of State. Members are corporately responsible for the overall operation of the Council and the stewardship of its funds.

The Chief Executive is appointed by the Council under a service contract and is an employee of the Milk Development Council. The Chief Executive has day to day responsibility for managing the Council's business, the control and the security of the Council's assets, preparation of the accounts and compliance with the Standard Orders and Financial Instructions laid down by the Council. The full Council annually approves the Chief Executive's remuneration, having regard to the level of performance during the year.

The Accounting Officer is responsible for ensuring that proper accounting records have been kept which disclose with reasonable accuracy at any time the financial position of the Council and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

ACCOUNTING OFFICER'S STATEMENT ON INTERNAL CONTROL

Scope

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of the policies, aims and objectives of the Milk Development Council, as established by the Council members carrying out their duties under Statutory Instrument 2005 No. 356, whilst safeguarding the organisation's funds and assets for which I am personally responsible, in accordance with the responsibilities assigned to me in *Government Accounting*.

Corporate Governance

During the year the Council implemented and reviewed a revised governance system with updated terms of reference and structure for MDC committees, and revised delegated authorities. The revised structure was confirmed by the Council as enhancing the system of control and accountability existing within the MDC. As part of the system of control there are a number of bodies charged with oversight of MDC's activities.

1. The Council

MDC Council Members perform their duties in accordance with their Code of Conduct and display any interests in the Register of Interests which is available for viewing at the MDC's offices. During the year the Council has updated its delegation of authorities to other bodies and the Executive, and updated the employee manual issued to all employees which details the procedure for whistleblowing as part of the procedures for the avoidance of fraud. Council members are also corporately responsible for implementing the MDC's approach to managing risk and strategically reviewing the internal controls of the organisation. Specific responsibility for reviewing and agreeing the processes for risk management and reviewing internal control procedures has been delegated to the Audit Committee which meets four times a year.

2. *MDC Management*

Each departmental manager provides a letter of representation confirming that the control mechanisms within their area of responsibility are operating correctly, and providing assurance to me as Accounting Officer in providing this statement. To assist them in maintaining the internal control systems on a day-to-day basis, there is an Operations and Procedures Manual that sets out the authorities, procedures and controls of the MDC. This is updated as required, and is subject to an annual review of all procedures and controls. All changes to the Manual have to be approved by the Audit Committee.

3. *Audit Committee*

The terms of reference for the MDC Audit Committee have been updated to incorporate current best practice for an organisation of MDC's size, and the role and function of the Audit Committee made discrete from other Council committees. The terms of reference are based on the Audit Committee Handbook issued by HM Treasury. Membership is drawn from existing Council members. The Chair is independent of all other duties and responsibilities within the MDC. The Audit Committee's primary responsibilities include monitoring the systems of internal control, approving the accounting policies and reviewing the annual financial statements. The Audit Committee meets a minimum of four times per year and regularly reviews the major risks facing the Milk Development Council identified at an organisational and departmental level.

4. *External Audit*

In line with other Non-Departmental Public Bodies the MDC's accounts are audited by the National Audit Office. This external audit contributes a further independent perspective on the internal financial control system. The external auditors report their findings to the Audit Committee on an annual basis, and recommendations are monitored for follow-up.

5. *Internal Audit*

Because of the limitations of size, the Milk Development Council does not have its own internal audit function, and this function is provided under contract to an external accounting firm, operating to Government Internal Audit Standards. An annual internal audit plan is drawn up and agreed with the external accounting practice. This plan is co-ordinated with that of the external auditors in order to ensure that full coverage is provided to all areas necessary to meet appropriate accounting and audit standards. I have ensured that the findings and recommendations concerning Corporate Governance and Risk Management identified during the year have been implemented.

6. *Defra*

In addition, I meet quarterly with representatives of our sponsoring department Defra to discuss operational and risk management issues that arise. During the year work has been carried out to update the Management Statement and Financial Memorandum covering the relationship between Defra and the MDC, agreement of which is pending. Throughout the year Defra provides advice, information and guidance to the MDC, and continues to monitor activities by the regular receipt of financial reports and minutes of operational matters.

Risk identification and management

Council members are corporately responsible for overseeing the MDC's approach to managing risk and strategically reviewing the risk register. The content of the risk register is agreed, owned and addressed by the Council, who oversee the embedding of risk management in the culture of the organisation.

Responsibility for reviewing and agreeing the processes for risk management, actions to mitigate likelihood and impacts of risks, are delegated by the Council to the Audit Committee, which meets a minimum of four times each year. Its terms of reference represent current best practice. The Audit Committee's primary responsibilities include monitoring the system of internal control, approving the accounting policies and reviewing the annual financial statements. The Audit Committee regularly reviews the major risks facing the MDC which have been identified by the management team and identified within our risk register.

Risks are managed hierarchically and subordinate risk registers to the overall risk register are held within each department. These risk registers identify the unmitigated risk levels, before mitigating action is taken, and residual risk, after action has been taken.

Risk management is part of the MDC's overall management activities, achieved by means of regular reviews by management and the maintenance of a risk register. Risk management has been embedded throughout the MDC's business processes and is regularly reviewed by the Audit Committee, who are given further assurance by the internal and external auditors.

The risk control framework

The key elements of this process are summarised below:

- the Audit Committee reviews the MDC's risk management process;
- a risk assessment programme has been developed that evaluates and prioritises the business risks relevant to the MDC;
- a Risk Register has been introduced that identifies those responsible for each risk and identifies the significance and likelihood of occurrence, the controls and procedures in place in respect of each risk and the actions taken, where appropriate, to manage risks to the desired level, and
- each department reports on a regular basis on the status of the business risks identified.

The Risk Register and the status of risks identified will continue to be updated through the risk assessment programme.

Internal Control and Performance Management

The system of internal control is designed to manage rather than eliminate the risks of failure to achieve 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 and prioritise the principal risks to the achievement of MDC policies, aims and objectives, to evaluate the likelihood of those risks being realised, and to manage them effectively and economically. This process has been in place in the MDC for the year ended 31 March 2006 and up to the date of approval of the Annual Report and Accounts, and accords with Treasury guidance.

The system of internal control provides only reasonable but not absolute assurance that the assets of the MDC are safeguarded, transactions are authorised and properly recorded, and that material errors and irregularities are either prevented or would be detected within a timely period. The system of internal financial control is based on a framework of regular management information, and administrative procedures including, as far as possible, given that the MDC employs a small administrative staff, the segregation of duties and a system of delegation and accountability. In particular it includes:

- a management structure that clearly defines authority, responsibility and accountability;
- an Operations and Procedures manual, substantially updated and re-written during the year, that documents the policies, systems and controls which are in place;
- staff performance appraisal scheme, designed to set objectives in line with the corporate plan deliverables;
- budgeting systems with an annual budget which is reviewed by the Audit and Finance Committees, and approved by the full Council;
- regular reviews by the Audit and Finance Committees and the full Council of periodic and annual financial reports that indicate and explain financial and physical performance against budgets;
- monitoring by the internal audit function on behalf of the Audit Committee in overseeing the work of the Chief Executive who has responsibility for the development and maintenance of the financial control framework;
- monitoring by the Audit and Finance Committees in overseeing the work of the Chief Executive and other MDC officers who have responsibility for the development and maintenance of the financial control framework, and following up on recommendations made by internal audit regarding corporate governance and risk management and by the external auditors in their management letter;
- setting targets to measure financial and other performance;
- clearly defined capital and investment control guidelines;
- a strategy and policy for identifying and managing key risks;
- as appropriate, formal project management disciplines;
- as far as practicable, given that the MDC employs a small administrative staff on efficiency grounds, the segregation of duties and a system of delegation and accountability.

Review of effectiveness

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control has been assisted by the work of the departmental managers who have responsibility for the development and maintenance of the internal control framework, and comments made by the external and internal auditors in their management letters and other reports. Whilst there have been no significant weaknesses brought to my attention during the year, I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Audit Committee, and a plan to address minor weaknesses identified and to ensure continuous improvement of the system is in place.



Kevin Bellamy
Chief Executive and Accounting Officer
19 October 2006

THE CERTIFICATE AND REPORT OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSE OF COMMONS AND THE SCOTTISH PARLIAMENT

I certify that I have audited the financial statements of the Milk Development Council for the year ended 31 March 2006 under Section 7 of the Industrial Organisation and Development Act 1947, as amended by the Government Resources and Accounts Act 2000 (Audit of Public Bodies) Order 2003 and the Scottish Act 1998. These comprise the Income and Expenditure Account, the Balance Sheet, the Cashflow Statement and Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Council Members, Chief Executive and auditor

The Council Members and Chief Executive are responsible for preparing the Annual Report, the Remuneration Report and the financial statements in accordance with Section 7 of the Industrial Organisation and Development Act 1947 and Ministerial directions made thereunder and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Chief Executive's Responsibilities.

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

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with Section 7 of the Industrial Organisation and Development Act 1947 and Ministerial directions made thereunder. I also report whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I also report to you if, in my opinion, the Annual Report is not consistent with the financial statements, if the Council has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by relevant authorities regarding remuneration and other transactions is not disclosed.

I review whether the statement on pages 25 to 28 reflects the Council's compliance with HM Treasury's guidance on the Statement on Internal Control, and I report if it does not. I am not required to consider whether the Accounting Officer's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Council's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises the Chairman's Report (on pages 3 to 4); the Chief Executive's Report (on pages 5 to 9); the Council Members' Profiles (on pages 10 to 11); the Operating and Financial Review (on pages 12 to 22); the unaudited part of the Remuneration Report (on pages 23 to 24); and the Statement of Accounting Officer's responsibilities in respect of the Accounts (on page 25). I consider the implications for my report if I become aware of any apparent misstatements or material inconsistencies with the financial statements. My responsibilities do not extend to any other information.

Basis of audit opinion

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Chief Executive in the preparation of the financial statements, and of whether the accounting policies are most appropriate to the Council's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by fraud or error and that in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

Opinions

In my opinion:

- the financial statements give a true and fair view, in accordance with Section 7 of the Industrial Organisation and Development Act 1947 as amended and directions made thereunder by Ministers, of the state of Council's affairs as at 31 March 2006 and of its deficit for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with Section 7 of the Industrial Organisation and Development Act 1947 as amended and Ministerial directions made thereunder; and
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.



John Bourn
Comptroller and Auditor General

National Audit Office
157-197 Buckingham Palace Road
Victoria
London SW1W 9SP

Date: 31 October 2006

**CONSOLIDATED INCOME AND EXPENDITURE ACCOUNT
FOR THE YEAR ENDED 31 MARCH 2006**

	Notes	2006 £	2005 as restated £
GROUP INCOME including SHARE OF ASSOCIATED COMPANY		8,270,623	7,542,861
Less: share of external income of associate company		(139)	(3,727)
TOTAL GROUP INCOME		8,270,484	7,539,134
COMPRISING:			
Levy Income	2	7,248,184	7,278,141
Other Income	3	226,787	72,993
EU Grant	4	750,000	188,000
Government (Defra) Grant	5	45,513	–
ADMINISTRATIVE COSTS	7	(1,498,682)	(1,208,333)
GROUP INCOME NET OF ADMINISTRATIVE COSTS		6,771,802	6,330,801
Generic Promotion Campaign in Scotland		(378,000)	(350,000)
EU funded Teenage Girls campaign	4	(1,498,400)	(409,098)
Cheese Promotion Campaigns		(400,890)	(388,528)
School Milk Campaigns		(695,574)	(680,016)
Dairy Council		(275,004)	(275,004)
MDC Evaluations Limited		(455,748)	(622,006)
Other organisational funding		(23,256)	(19,048)
Research and development project expenditure		(1,086,532)	(1,231,624)
Promotional funding & market development expenditure		(1,173,147)	(1,503,414)
Communicating spend & regional extension officers		(1,147,495)	(1,098,588)
TOTAL GRANTS AND PROJECT EXPENDITURE		(7,134,046)	(6,577,326)
GROUP OPERATING (DEFICIT) BEFORE EXCEPTIONAL INCOME		(362,244)	(246,525)
Exceptional income	10	23,783	80,000
GROUP OPERATING (DEFICIT) AFTER EXCEPTIONAL INCOME		(338,461)	(166,525)
Share of operating (deficit)/surplus in associate company		(45,841)	28,899
TOTAL OPERATING (DEFICIT)/SURPLUS		(384,302)	(137,626)
Group interest receivable (net)	6	134,936	145,215
Share of interest receivable in associate company		8,542	11,129
(DEFICIT)/SURPLUS OF INCOME OVER EXPENDITURE BEFORE TAXATION		(240,824)	18,718
Group taxation		(28,393)	(33,624)
Share of taxation in associate company		(841)	(1,408)
Minority interest		(3,050)	14,597
DEFICIT RETAINED FOR THE YEAR		(273,108)	(1,717)
NOTIONAL COST OF CAPITAL	12	119,050	109,170

Income and operating surplus for the year relate to continuing operations.

The Notes on pages 38 to 55 form part of these financial statements

**INCOME AND EXPENDITURE ACCOUNT
FOR THE YEAR ENDED 31 MARCH 2006
(Milk Development Council Only)**

	Notes	2006 £	2005 as restated £
INCOME			
Levy Income	2	7,248,184	7,278,141
Other income	3	202,057	50,860
EU Grant	4	750,000	188,000
Other Grants	5	45,513	–
ADMINISTRATIVE COSTS	7	(1,498,652)	(1,208,318)
LEVY INCOME NET OF ADMINISTRATIVE COSTS		6,747,102	6,308,683
Generic Promotion Campaign in Scotland		(378,000)	(350,000)
EU funded Teenage Girls campaign	4	(1,498,400)	(409,098)
Cheese Promotion Campaigns		(400,890)	(388,528)
School Milk Campaigns		(695,574)	(680,016)
Dairy Council		(275,004)	(275,004)
MDC Evaluations Limited		(483,880)	(449,996)
Other organisational funding		(23,256)	(19,048)
Research and development project expenditure		(1,037,652)	(1,231,624)
Promotional funding & market development expenditure		(1,173,147)	(1,503,414)
Communicating spend & regional extension officers		(1,147,495)	(1,098,588)
TOTAL GRANTS AND PROJECT EXPENDITURE		(7,113,298)	(6,405,316)
OPERATING DEFICIT BEFORE EXCEPTIONAL INCOME		(366,196)	(96,633)
Exceptional income	10	–	80,000
OPERATING DEFICIT AFTER EXCEPTIONAL INCOME		(366,196)	(16,633)
Interest receivable (net)	6	131,476	139,691
(DEFICIT)/SURPLUS OF INCOME OVER EXPENDITURE BEFORE TAXATION		(234,720)	123,058
Taxation	11	(27,671)	(31,999)
(DEFICIT)/SURPLUS RETAINED FOR THE YEAR		(262,391)	91,059
NOTIONAL COST OF CAPITAL	12	119,425	109,060

Income and operating surplus for the year relate to continuing operations.
The Notes on pages 38 to 55 form part of these financial statements.

**STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES
FOR THE YEAR ENDED 31 MARCH 2006**

	Notes	2006		2005 as restated	
		£	£	£	£
		Group	Council	Group	Council
(Deficit)/surplus for the financial year		(273,108)	(262,391)	(1,717)	91,059
Actuarial (loss)/gain on pension scheme		(80,000)	(80,000)	40,000	40,000
TOTAL RECOGNISED GAINS AND LOSSES RELATING TO THE YEAR		(353,108)	(342,391)	38,283	131,059
Prior year adjustment	29	(1,380)	(40,000)		
TOTAL RECOGNISED GAINS AND LOSSES SINCE LAST ANNUAL REPORT		(354,488)	(382,391)	38,283	131,059

The Notes on pages 38 to 55 form part of these financial statements.

CONSOLIDATED BALANCE SHEET AT 31 MARCH 2006

	Notes	2006 £	2005 as restated £
NON-CURRENT ASSETS			
Fixed asset investments	14	200	200
Tangible fixed assets	13	89,265	31,102
Investments in associate company	14	223,267	261,407
		312,732	292,709
CURRENT ASSETS			
Stock		4,690	340
Debtors due within one year	15	2,282,069	2,169,515
Debtors due after more than one year	15	95,574	134,887
Initial funding for projects	16	33,294	104,747
Cash at bank and in hand	19	2,952,186	3,112,870
TOTAL CURRENT ASSETS		5,367,813	5,522,359
CREDITORS: amounts falling due within one year	17	(2,489,495)	(2,373,960)
NET CURRENT ASSETS		2,878,318	3,148,399
TOTAL ASSETS LESS CURRENT LIABILITIES		3,191,050	3,441,108
NET ASSETS EXCLUDING PENSION LIABILITY		3,191,050	3,441,108
PENSION LIABILITY	25	(140,000)	(40,000)
NET ASSETS		3,051,050	3,401,108
CAPITAL AND RESERVES			
Retained surplus	20	1,657,098	1,833,562
Market Development Reserve Fund	21	1,391,111	1,567,755
Minority Interests		2,841	(209)
		3,051,050	3,401,108

The Notes on pages 38 to 55 form part of these financial statements.

Approved by the Council and signed on its behalf



Brian Peacock
Chairman



Kevin Bellamy
Chief Executive and Accounting Officer

Date 19 October 2006

BALANCE SHEET AT 31 MARCH 2006
(Milk Development Council Only)

	Notes	2006 £	2005 as restated £
FIXED ASSETS			
Fixed asset investments	14	1	1
Tangible fixed assets	13	89,265	31,102
		89,266	31,103
CURRENT ASSETS			
Stock		4,690	340
Debtors due within one year	15	2,274,325	2,138,033
Debtors due after more than one year	15	95,574	134,887
Initial funding for projects	16	33,294	104,747
Cash at bank and in hand	19	2,912,255	2,998,899
TOTAL CURRENT ASSETS		5,320,138	5,376,906
CREDITORS: amounts falling due within one year	17	(2,469,156)	(2,225,370)
NET CURRENT ASSETS		2,850,982	3,151,536
TOTAL ASSETS LESS CURRENT LIABILITIES		2,940,248	3,182,639
NET ASSETS EXCLUDING PENSION LIABILITY		2,940,248	3,182,639
PENSION LIABILITY	25	(140,000)	(40,000)
NET ASSETS		2,800,248	3,142,639
CAPITAL AND RESERVES			
Retained surplus	20	1,409,137	1,574,884
Market Development Reserve Fund	21	1,391,111	1,567,755
		2,800,248	3,142,639

The Notes on pages 38 to 55 form part of these financial statements.

Approved by the Council and signed on its behalf



Brian Peacock
Chairman



Kevin Bellamy
Chief Executive and Accounting Officer

Date 19 October 2006

CONSOLIDATED STATEMENT OF CASH FLOWS AT 31 MARCH 2006

	Notes	2006 £	2005 £
NET CASH FLOW FROM OPERATING ACTIVITIES	18	(193,719)	(49,422)
EXCEPTIONAL INCOME		23,783	80,000
RETURNS ON INVESTMENTS AND SERVICING OF FINANCE			
Interest received		129,936	145,215
TAXATION			
Tax paid		(30,141)	(9,054)
CAPITAL EXPENDITURE			
Amounts paid to acquire tangible fixed assets		(90,543)	(31,775)
CASH FLOW BEFORE USE OF LIQUID RESOURCES		(160,684)	134,964
ANALYSIS OF CASH AT YEAR END			
Increase in cash deposits		708,910	22,495
(Decrease)/increase in term cash deposits		(869,594)	112,469
(DECREASE)/INCREASE IN CASH	19	(160,684)	134,964

The Notes on pages 38 to 55 form part of these financial statements.

STATEMENT OF CASH FLOWS AT 31 MARCH 2006
(Milk Development Council Only)

	Notes	2006 £	2005 £
NET CASH FLOW FROM OPERATING ACTIVITIES	18	(93,128)	15,707
EXCEPTIONAL INCOME		–	80,000
RETURNS ON INVESTMENTS AND SERVICING OF FINANCE			
Interest received		126,476	139,691
TAXATION			
Tax paid		(29,449)	(7,949)
CAPITAL EXPENDITURE			
Amounts paid to acquire tangible fixed assets		(90,543)	(31,775)
CASH FLOW BEFORE USE OF LIQUID RESOURCES		(86,644)	195,674
ANALYSIS OF CASH AT YEAR END			
Increase in cash deposits		554,090	350,671
Decrease in term cash deposits		(640,734)	(154,997)
(DECREASE)/INCREASE IN CASH		(86,644)	195,674

The Notes on pages 38 to 55 form part of these financial statements.

NOTES TO THE ACCOUNTS AT 31 MARCH 2006

1. ACCOUNTING POLICIES

Basis of preparation

The accounts are intended to comply with best commercial practice including Statements of Standard Accounting Practice and the Financial Reporting Standards issued by the Accounting Standards Board. The accounts have been prepared in accordance with a form agreed with the Department for Environment, Food and Rural Affairs under Section 7 of the Industrial Organisation and Development Act 1947, and in accordance with the 2005-06 Government Financial Manual (FReM) issued by HM Treasury.

The accounting policies contained in the FReM follow generally accepted accounting practice for companies (UK GAAP) to the extent that it is meaningful and appropriate to the public sector. Where the FReM permits a choice of accounting policy, the accounting policy which has been judged to be most appropriate to the particular circumstances of the Milk Development Council (MDC) for the purpose of giving a true and fair view has been selected.

Accounting convention

The accounts have been prepared under the modified historical cost accounting convention in which the income and expenditure account reflects the consumption of resources at their current value and the balance sheet shows the value of fixed assets at their value to the business by reference to current costs.

For the year ended 31 March 2006 the company has fully adopted the pension scheme disclosures required by FRS17 'Retirement Benefits' in the accounts for the first time.

Basis of consolidation

The consolidated financial statements merge the financial statements of the Milk Development Council and the two companies under its control, Milk Development Council Holdings Limited and Milk Development Council Evaluations Limited (MDCEL). In those years when mergers take place, the whole of the results, assets, liabilities and shareholders' funds of the merged entities are consolidated, regardless of the actual merger date, and corresponding figures for previous years are re-stated.

The twelve month period covered by the financial statements of the Milk Development Council and the two companies under its control are co-terminous, ending on 31 March. Separate audited accounts are prepared for the two companies and are filed with the Registrar of Companies.

Associate company

During the year ended 31 March 2006 Milk Development Council Holdings Limited held a 50% interest in The Dairy Council with the other 50% held by Dairy UK Limited. The Group's share of the results of this company is included in the consolidated income and expenditure account using the equity method of accounting, and its interest in the company's net assets is included at cost in the consolidated balance sheet. The twelve month period covered by the financial statements of The Dairy Council ends on 31 March.

Fixed asset investments

Fixed asset investments are stated at the lower of cost or net realisable value.

Tangible fixed assets

All tangible fixed assets are held at cost less accumulated depreciation. The Council is of the opinion that there is no material difference between the value shown in the financial statements and the current market value in the existing use of the assets.

Stocks

Stocks comprise 'Feed into Milk' disks. These are stated at the lower of historical cost and net realisable value.

Operating lease agreements

Rentals applicable to operating leases where substantially all of the benefits and risks of ownership remain with the lessor are charged against profits as incurred.

Levy income

Levy income is credited to the Income and Expenditure account on a receivable basis and adjusted as necessary for any amounts whose recovery is considered to be in doubt.

Depreciation

Depreciation is provided on all tangible fixed assets from the date of acquisition, at rates calculated to write off the cost, less estimated residual value at the date of acquisition, of each asset evenly over its expected useful life, as follows:

Operating system software	– over 3 years
Other software	– over 1 year
Computer hardware	– over 2 years
Fixture and fittings	– over 2 years

Research and development project expenditure

Expenditure is charged on an accruals basis, comparing the actual amount paid with project work performed, assuming that the work performed is spread evenly over the life of a project.

Grants

Government grants are recognised in the Income and Expenditure account on a systematic basis over the duration of the project to which the grant relates and in the financial years necessary to match them with the related costs. The grants are not recognised in the Income and Expenditure account before the conditions attaching to the grant have been fulfilled.

Foreign currency account

A bank account is held in Euros to facilitate transactions with other European organisations. Transactions in Euros are translated into sterling at the exchange rate in operation on the date of the transaction. The balance on this account is translated into sterling at the rate in operation at the balance sheet date. All revaluation differences and realised foreign exchange differences are taken to the income and expenditure account.

Pension costs – change of accounting policy

The company has applied the full requirements of FRS17 ‘*Retirement Benefits*’, for the first time this year. This has resulted in the scheme deficit being recognised and the expense being the estimated cost of providing the benefits accrued in the year, where previously the expense had effectively been the contributions payable per the funding plan.

The impact of this change in accounting policy is shown in Note 29.

For defined benefit schemes the amount charged to the profit and loss account in respect of pension costs and other post retirement benefits is the estimated regular cost of providing the benefits accrued in the year, adjusted to reflect variations from that cost. The interest cost and expected return on assets are included within other finance costs.

Actuarial gains and losses arising from new valuations and from updating valuations to the balance sheet date are recognised in the Statement of Total Recognised Gains and Losses.

Defined benefit schemes are funded, with the assets held separately from the company in separate trustee administered funds. Full actuarial valuations, by a professionally qualified actuary, are obtained at least every three years, and updated to reflect current conditions at each balance sheet date. The pension scheme assets are measured at fair value. The pension scheme liabilities are measured using the projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency. A pension scheme asset is recognised on the balance sheet only to the extent that the surplus may be recovered by reduced future contributions or to the extent that the trustees have agreed a refund from the scheme at the balance sheet date. A pension scheme liability is recognised to the extent that the company has a legal or constructive obligation to settle the liability.

For defined contribution schemes the amount charged to the profit and loss account in respect of pension costs and other post retirement benefits is the contributions payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

Contingent liabilities

Contingent liabilities are disclosed in accordance with FRS12.

2. LEVY INCOME

On 7 February 1995 the Milk Development Council Order 1995 came into effect. This provided for the imposition of a levy on milk produced for sale, specified as not to exceed 0.05 pence per litre (ppl). Following a positive milk producer referendum and approval by the Welsh Assembly, the Scottish Parliament, Westminster and Brussels, the Milk Development Council (Amendment) Order 2000 legislation allowed the increase of the maximum statutory levy to 0.08 ppl (inclusive of VAT) from 1 April 2000 to encompass support for a generic promotion campaign. From the income raised, and in line with the above Order, approval was given to spend £3.1 million on the "promoting or undertaking arrangements for better acquainting the public in the United Kingdom with the goods and services supplied by the industry and methods of using them." The total levy approved by the Ministers for the year to 31 March 2006 was 0.06 ppl (for the year ended 31 March 2005: 0.06 ppl).

3. OTHER INCOME

Other income in the year ended 31 March 2006 relates to match-funding on projects from external sources, and sales of statistical information, 'Feed into Milk' disks, sundry publications and services to non-levy payers totaling £202,057 (2005: £50,860). Income generated by Milk Development Council Evaluations Limited from external sources came to £24,730 (2005: £22,133).

4. EU GRANT

In January 2005 the European Commission awarded £1.5 million to the MDC to match-fund a new campaign promoting the benefits of milk, cheese and yogurt to teenage girls (Teenage Girls campaign). The campaign will run for two years, and several British dairies and co-operatives are committed to supporting this campaign with in-kind funding. The MDC accrues for the income due from the EU Grant on a systematic basis over the duration of the project.

5. GOVERNMENT (Defra) GRANT

During the year MDC were awarded a grant from Defra not to exceed £386,000 over a three year period under The Agriculture Development Scheme, towards a project (Business Improvement in the Dairy Sector), to be carried out in collaboration with Dairy Farmers of Britain, Milklink Distribution Ltd and First Milk Ltd. The project started in June 2005, and interim payments are made quarterly in arrears on submission of a statement of costs expended on the project. Income has been taken to the Income and Expenditure account to match with related costs in the relevant year, irrespective of the date of receipt of such income.

6. INTEREST RECEIVABLE

Levy monies are placed on interest-earning short and medium term deposits. Income is accounted for on an accruals basis.

	2006		2005	
	£		£	
	Group	Council	Group	Council
Interest receivable (net)	129,936	126,476	145,215	139,691
Net finance charge on pensions scheme assets and liabilities (note 25)	5,000	5,000	–	–
	134,936	131,476	145,215	139,691

7. ADMINISTRATIVE COSTS

	Central Services £	Direct Council costs £	Communications & Public Relations £	Total £
Year ended 31 March 2006				
Council members' honoraria (<i>see note 8</i>)	–	59,250	–	59,250
Council members' travel and subsistence	–	59,048	–	59,048
Staff costs (<i>see note 9</i>)	382,839	51,412	163,286	597,537
Rent, rates and office maintenance	67,019	–	–	67,019
Printing, stationery and office supplies	65,571	4,061	4,768	74,400
Telecommunications	18,867	1,203	1,433	21,503
Computer costs	38,197	1,294	28,115	67,606
Publicity and communications	–	–	392,027	392,027
Auditors' remuneration	18,796	–	–	18,796
Other professional services	62,778	–	–	62,778
Depreciation	29,084	–	–	29,084
Amortisation of prepaid rent	39,313	–	–	39,313
Write-off of bad debts	(9,501)	–	–	(9,501)
Provision for doubtful debts	3,206	–	–	3,206
Provision for legal liability	–	–	–	–
Other administrative costs	16,586	–	–	16,586
MILK DEVELOPMENT COUNCIL	732,755	176,268	589,629	1,498,652
MDC HOLDINGS LIMITED	30	–	–	30
CONSOLIDATED	732,785	176,268	589,629	1,498,682
Year ended 31 March 2005 as restated				
Council members' honoraria (<i>see note 8</i>)	–	67,125	–	67,125
Council members' travel and subsistence	–	56,784	–	56,784
Staff costs (<i>see note 9</i>)	331,569	47,020	109,799	488,388
Rent, rates and office maintenance	60,591	–	–	60,591
Printing, stationery and office supplies	97,030	1,143	39,588	137,761
Telecommunications	15,635	1,518	2,709	19,862
Computer costs	47,696	626	16,487	64,809
Publicity and communications	–	–	237,281	237,281
Auditors' remuneration	12,000	–	–	12,000
Other professional services	91,343	–	18,053	109,396
Depreciation	24,815	–	–	24,815
Amortisation of prepaid rent	18,083	–	–	18,083
Write-off of bad debts	57,632	–	–	57,632
Provision for doubtful debts	(60,923)	–	–	(60,923)
Provision for legal liability	(115,500)	–	–	(115,500)
Other administrative costs	30,214	–	–	30,214
MILK DEVELOPMENT COUNCIL	610,185	174,216	423,917	1,208,318
MDC HOLDINGS LIMITED	15	–	–	15
CONSOLIDATED	610,200	174,216	423,917	1,208,333

Payments made during the year under operating leases were for land and buildings £30,000 (2005: £30,000), and for telephone equipment £3,176 (2005: £3,176).

There was no remuneration paid to auditors for non-audit services during the year (2005: nil).

8. EMOLUMENTS OF COUNCIL MEMBERS AND EMPLOYEES

Chairman and council members

The emoluments of the Chairman were £34,849 (2005: £33,999). No pension contributions are paid for the Chairman.

Council members do not receive remuneration but can claim an honorarium of £150 per day (2005: £150 per day) for meetings attended, or for work carried out solely on the Council's behalf. No pension contributions are paid for Council members. The following honoraria payments have been made:

	Honoraria payments for the year ended:	
	31 March 2006	31 March 2005
	£	£
Michael Brearley	4,875	5,700
William Campbell	6,675	6,975
Rosemary Collingborn	6,600	6,825
Christian Fox	8,400	9,900
Ian Gordon	1,800	3,450
David Homer	8,025	9,150
Gwyn Jones	3,825	6,300
Thomas Jones	5,400	7,350
Trevor Lloyd	10,275	6,250
Jonathan Vickers	3,900	5,475

Chief executive and director

The gross emoluments of the Chief Executive (who is not a Council member) were £74,308 (2005: £70,690), plus a car allowance of £6,600 (2005: £6,600). The gross emoluments include provision of private health cover. Additionally, gross pension contributions were paid on behalf of the Chief Executive of £19,820 (2005: £19,443). The cash equivalent transfer value of the pension of the Chief Executive under a defined benefit pension scheme at 31 March 2006 was £51,375 (2005: £40,399). The accrued scale pension as at 31 March 2005 was £6,688 per annum and as at 31 March 2006 the figure was £9,967 per annum. The accrued scale pension has, therefore, increased by £3,279 a year over the last twelve months.

9. STAFF COSTS

	Administrative services	Projects	Total 2006	Total 2005 as restated
	£	£	£	£
Wages and salaries	398,160	851,984	1,250,144	1,071,950
Social security costs	45,927	86,686	132,613	128,398
Other pension costs	71,401	55,784	127,185	82,453
Temporary staff	6,794	23,749	30,543	6,414
Private medical insurance	7,248	7,204	14,452	10,860
Termination payments	–	–	–	15,659
Recruitment costs	3,313	30,295	33,608	36,148
Training costs	25,506	15,314	40,820	39,882
Other staff related costs	39,188	169,049	208,237	189,934
	597,537	1,240,065	1,837,602	1,581,698

Other staff related costs include expenditure on travel and subsistence, business entertainment, and staff catering.

The number of employees earning in excess of £40,000 (excluding pension contributions) is as follows:

	2006	2005
	No.	No.
Between £70,000 and £74,999	1	1
£65,000 and £69,999	–	–
£60,000 and £64,999	1	1
£55,000 and £59,999	–	–
£50,000 and £54,999	1	–
£45,000 and £49,999	4	2
£40,000 and £44,999	–	2

The average number of employees during the year was 48 (2005: 43). The average number of staff employed on project and marketing work, including the chief executive, was 37 (2005: 35), and on administration and communications work the average number was 11 (2005: 8).

The number of employees by activity at the end of the year was as follows:

	2006	2005
	No.	No.
Chief executive	1	1
Farm management & Genetics	6	5
Extension officers	8	6
Market development	5	4
School milk facilitators	14	14
Market information service	6	5
Finance & Administration	7	6
Communications & Public Relations	4	3
	51	44

Pension Costs

MDC offers access to stakeholder pension schemes for all its employees in accordance with statutory pension requirements.

A Group personal pension plan has been arranged with the NFU Mutual Insurance Society, and is offered to all employees in accordance with their contractual conditions of employment. Thirty-three employees have exercised this option (2005: 20). Contributions to the plan made by the Council are in proportion to the employees' contributions. The Council's contribution to the plan is subject to a maximum of 12.5% of an employee's pensionable earnings as long as a contribution of 5% is made by the employee on the same earnings. Employees can contribute more than 5% of their pensionable earnings to the plan up to the limit established by statute. Contributions made by the Council in the year ended 31 March 2006 were £84,020 (2005: £67,123).

At the end of the year two employees were in The Milk Pension Scheme, which is a final pensionable salary scheme. This pension scheme is no longer available to new staff. The level of contribution is determined by actuarial valuation. To meet current and future liabilities of the Scheme, employer contributions for the period were set by the actuary at 17.4% of pensionable earnings per annum (2005: 17.4%). Members contribute at a rate of 5% of pensionable earnings per annum. Contributions made by the Council in the year ended 31 March 2006 were £160,165 (2005: £25,330).

Details of pension commitments are provided in Note 25 to these Accounts.

10. EXCEPTIONAL INCOME

A Redundancy Trust Fund had been established by previous owners of MDC Evaluations Ltd to provide a basis for the final settlement of termination payments, due to employees of the former Milk Marketing Board, under a redundancy agreement drawn up at the time of the dissolution of that body. During the year ended 31 March 2006 the terms of this agreement came into effect, and termination payments were made in accordance with that agreement. The provisions of the Trust Fund having been satisfied, the Fund was wound up and the remaining balance of £23,783 returned to MDCEL, as allowed by the terms of the Trust Fund. (2005: exceptional income of £80,000 was received by MDC in respect of settlement of an insurance claim.)

11. TAXATION (MILK DEVELOPMENT COUNCIL ONLY)

The current and previous year tax charges are as below:

	2006	2005
	£	as restated £
Factors affecting the tax charge for the year:		
Surplus of income over expenditure before taxation	(234,720)	123,058
Surplus multiplied by standard rate of corporation tax in the UK of 30% (2005 – 30%)	(70,416)	36,917
Effect of:		
Expenses not deductible for tax purposes	0	0
Capital allowances for the year less than net depreciation	9,714	10,377
Non-taxable items	98,645	(5,386)
Utilisation of small companies rate of corporation tax of 7.1% (2005 – 7.1%)	(10,272)	(9,909)
Current tax charge for year	27,671	31,999

The Inland Revenue has confirmed that the Milk Development Council is exempt from corporation tax on the basis that its principal activities do not constitute a trade.

The Council will continue to pay tax on its bank interest received and chargeable gains. Provision has been made for a tax liability on the bank interest received.

12. NOTIONAL COST OF CAPITAL

HM Treasury requires Non-Departmental Public Bodies to make a notional charge in their accounts for the cost of capital employed in their activities. The notional cost of capital represents the opportunity cost of the investment provided by the levy payers. Given the nature of the MDC's business and its funding arrangements, notably the fact that it does not receive grant-in-aid, the Council considers it would be inappropriate to include such a charge in the Income and Expenditure Account. However, the notional cost of capital is shown as a memorandum item. In the year ended 31 March 2006 this is determined by applying 3.5% (2005: 3.5%) to the average capital employed by the MDC during the year, and indicates the return on the investment that an investor would otherwise be able to expect at the same level of risk.

13. TANGIBLE FIXED ASSETS

	Computer equipment		Fixtures and fittings		Total	
	Group	Council	Group	Council	Group	Council
	£		£		£	
Cost:						
At 1 April 2005	155,857	155,857	43,478	43,478	199,335	199,335
Additions	88,672	88,672	1,871	1,871	90,543	90,543
Disposals	–	–	–	–	–	–
At 31 March 2006	244,529	244,529	45,349	45,349	289,878	289,878
Depreciation:						
At 1 April 2005	136,182	136,182	32,051	32,051	168,233	168,233
Provided during the year	24,561	24,561	7,819	7,819	32,380	32,380
Disposals	–	–	–	–	–	–
At 31 March 2006	160,743	160,743	39,870	39,870	200,613	200,613
Net book value						
At 31 March 2006	83,786	83,786	5,479	5,479	89,265	89,265
At 1 April 2005	19,675	19,675	11,427	11,427	31,102	31,102

The computer equipment and software necessary to continue the operations of MDC Holdings' subsidiary company, MDCEL, were transferred in 2005 to SAC Commercial Limited free of charge. At the termination of the contract with SAC Commercial Limited, MDCEL has the right to re-acquire at no cost any such original equipment as has been transferred. The fixed assets of MDCEL have been written-off in the books of that company.

The Council members have reviewed the value of fixed assets and believe that no impairment has occurred. The Council members believe that the value shown in the financial statements represents the current value of fixed assets to the business. Reviews are made annually of the estimated remaining lives of individual assets, taking account of commercial and technological obsolescence as well as normal wear and tear.

14. FIXED ASSET INVESTMENTS

Group

MDC Holdings Limited holds 50% share of The Dairy Council with the other 50% held by Dairy UK Limited. The financial results of the entity up to 31 March 2006 are included in the consolidated accounts of the Group, on the basis that it is an associate.

The Group's share of the results of The Dairy Council as at 31 March 2006 were:

	2006	2005
	£	£
Share of turnover of associate	<u>139</u>	<u>3,728</u>
Share of profit before tax of associate	<u>(37,299)</u>	40,028
Share of tax of associate	<u>(841)</u>	<u>(1,408)</u>
Share of profit after tax of associate	<u>(38,140)</u>	<u>38,620</u>
Share of fixed assets	15,578	1,265
Share of current assets	<u>256,567</u>	<u>402,877</u>
	272,145	404,142
Share of current liabilities	<u>(48,878)</u>	<u>(142,735)</u>
Share of net assets	<u>223,267</u>	<u>261,407</u>

MDC Holdings Limited also holds 200 £1 shares in Promise Fertility Limited.

Council

The Milk Development Council controls MDC Holdings Limited, a company limited by guarantee. The extent of its investment is the guarantee of £1 in the event of MDC Holdings Limited being wound up.

15. DEBTORS

	2006		2005	
	£		£	
	Group	Council	Group	Council
Debtors due within one year:				
Levy due from milk wholesalers	1,129,276	1,129,276	1,314,758	1,314,758
Levy due from producer retailers	667,511	667,511	460,261	460,261
Other debtors	27,462	21,123	76,960	50,879
Prepayments and accrued income	457,820	455,015	317,536	310,735
Amounts owed by subsidiary of MDC (see Note 26)	–	1,400	–	1,400
	2,282,069	2,274,325	2,169,515	2,138,033
Debtors due after more than one year:				
Prepaid rent	95,574	95,574	134,887	134,887
	2,377,643	2,369,899	2,304,402	2,272,920

16. INITIAL FUNDING FOR PROJECTS (Group and Milk Development Council)

	2006	2005
	£	£
Initial funding for projects	33,294	104,747

Initial funding for projects represents payments made to research organisations in accordance with contractually agreed terms to finance initial project outlays that are in excess of work performed to date.

17. CREDITORS: amounts falling due within one year

	2006		2005	
	£		£	
	Group	Council	Group	Council
Corporation tax	27,701	27,671	32,519	31,999
Other taxes (VAT) and social security	135,870	126,226	58,664	58,664
Trade creditors	670,460	670,460	762,991	762,991
Other creditors	35,516	35,517	43,841	43,842
Accruals and deferred income	1,619,948	1,609,282	1,352,105	1,327,874
Redundancy Trust Fund (see Note 10)	–	–	123,840	–
	2,489,495	2,469,156	2,373,960	2,225,370

Accruals and deferred income mainly represent project costs spread evenly over the life of projects in excess of the actual charges received.

18. RECONCILIATION OF OPERATING DEFICIT TO NET CASH FLOW FROM OPERATING ACTIVITIES

	2006		2005	
	£		as restated	
	£	£	£	£
	Group	Council	Group	Council
Operating deficit	(362,244)	(366,196)	(246,525)	(96,633)
Depreciation	32,380	32,380	24,497	34,585
Surplus depreciation on disposals	–	–	(631)	(631)
(Increase)/Decrease in stocks	(4,350)	(4,350)	3,053	3,053
(Increase) in debtors and initial funding for projects	(1,788)	(25,526)	(368,071)	(328,793)
Increase in creditors	115,535	243,786	930,152	790,045
Increase/(Decrease) in provisions	25,000	25,000	(367,327)	(367,327)
Movement in taxation	1,748	1,778	(24,570)	(18,592)
Net cash flow from operating activities	(193,719)	(93,128)	(49,422)	15,707

19. ANALYSIS OF CASH BALANCES SHOWN IN THE BALANCE SHEET

	1 April 2005		Cash Flow		31 March 2006	
	£		£		£	
	Group	Council	Group	Council	Group	Council
Cash at bank	447,095	606,468	708,910	548,212	1,156,005	1,154,680
Guarantee account	134,280	134,280	5,878	5,878	140,158	140,158
Medium term deposits	2,531,495	2,258,151	(875,472)	(640,734)	1,656,023	1,617,417
	3,112,870	2,998,899	(160,684)	(86,644)	2,952,186	2,912,255

The MDC had to secure a performance bond as part of the conditions for EU match funding of the Teenage Girls campaign. This facility has been supported by an amount of £134,280 set aside in a guaranteed fixed deposit account for a term of two years covering the duration of the campaign. The cash flow on this account represents interest earned.

20. RETAINED SURPLUS

	2006		2005 as restated	
	£		£	
	Group	Council	Group	Council
Surplus b/f at 1 April	1,873,562	1,614,884	1,705,247	1,576,580
Prior period adjustment in respect of FRS17	(40,000)	(40,000)	(65,000)	(65,000)
Prior period adjustment in respect of the Dairy Council	–	–	222,787	–
At 1 April as restated	1,833,562	1,574,884	1,863,034	1,511,580
(Deficit)/surplus for the year	(273,108)	(262,391)	(1,717)	91,059
Transfer from/(to) Market Development Reserve Fund	176,644	176,644	(67,755)	(67,755)
Actuarial (loss)/gain on pension scheme	(80,000)	(80,000)	40,000	40,000
Surplus carried forward at 31 March	1,657,098	1,409,137	1,833,562	1,574,884

21. MARKET DEVELOPMENT RESERVE FUND

	2006	2005
	£	£
Reserve Fund at 1 April	1,567,755	1,500,000
Surplus for the year retained in Reserve Fund (interest earned)	–	67,755
Utilisation of Fund for the year	(176,644)	–
Transfer from retained surplus	–	–
Surplus carried forward at 31 March	1,391,111	1,567,755

The Market Development Reserve Fund is a fund set aside solely for the support of promotional activities that attract match-funded grants where it is a condition to maintain an account separate from the retained surplus of the MDC.

22. FUTURE FUNDING COMMITMENTS

		2006	2005
		£	£
Contracted and falling due:	in one year	3,287,759	2,695,427
	in one to two years	860,155	1,585,118
	In two to five years	479,185	351,740
		4,627,099	4,632,285

Commitments approved by the Council represent research and development projects, promotional projects and grants to other bodies associated with the dairy industry.

Included in the above are payments of £1,089,302 due in one year for the MDC campaign to encourage milk and dairy consumption amongst teenage girls (2005: £749,196 due in one year; £561,897 due within one to two years). This campaign is match-funded by a grant of a similar amount from the European Union (see Note 4).

Included in the above are commitments of £129,167 due in one year, and £166,833 due in one to two years (2005: nil) on the Business Improvement in the Dairy Sector (BIDS) project (see Note 5).

Included in the above are future funding commitments of £400,000 a year over the next three years to MDC Holdings' subsidiary company (MDCEL). This grant enables MDCEL to perform its genetic evaluation activities. MDCEL has out-sourced its operational services under a non-cancellable operating lease. Payments under that lease are £269,000 due to fall in one year, and £277,000 due to fall in two to five years (2005: £317,000 due in one year; £269,000 due in two to five years).

23. CAPITAL COMMITMENTS

There were no capital commitments at 31 March 2006 (2005: nil).

24. OTHER FINANCIAL COMMITMENTS

At 31 March 2006, the MDC had the following annual commitments under non-cancellable operating leases:

	2006	2006	2006	2005	2005	2005
	Land & buildings	Others	Total	Land & buildings	Others	Total
	£	£	£	£	£	£
Operating leases which expire:						
In one year	–	–	–	–	–	–
In one to two years	–	3,176	3,176	–	–	–
In two to five years	13,000	–	13,000	13,000	3,176	16,176

25. PENSION COMMITMENTS

Defined benefit pension scheme (The Milk Pension Fund)

The Milk Development Council participates in a multi-employer defined benefit pension scheme, The Milk Pension Fund, which is funded by contributions from employees, and participating companies and organisations. The Milk Pension Fund contains several participating employers, and the assets and liabilities of the Fund are allocated between employers.

As a result of the identification of these assets and liabilities, in accordance with the FReM, the MDC has fully adopted the requirements of Financial Reporting Standard 17 "Retirement Benefits" (FRS17) for the year ended 31 March 2006. The ability to identify separately the assets and liabilities of the scheme relating to the MDC and the adoption of FRS17 has required a change to the accounting treatment of defined benefit scheme arrangements such that the MDC includes the pension liability in the company's balance sheet. Current service costs, curtailment and settlement gains and losses, and net financial returns are included in the income and expenditure account in the period to which they relate. Actuarial gains and losses are recognised in the statement of total recognised gains and losses.

For the purpose of setting contribution rates and allocation of assets and liabilities, MDC and its associated undertaking, MDCEL, are considered as the same participating employer in the Fund. At the end of the year there were two active members (2005: three active members), four deferred pensioners (2005: four), and one pensioner (2005: none) in The Milk Pension Fund. The total cost of contributions to the scheme by the MDC in the year ended 31 March 2006 was £160,165 (2005: £25,330). There were no amounts outstanding to the Fund at the year end.

The following statistics have been obtained from an independent qualified actuary in accordance with the requirements of FRS17 (*Accounting for Retirement Benefits*). The latest actuarial valuation of the Fund was made as at 31 March 2003; the next one is due as at 31 March 2006.

Assets – the asset data (for the whole Fund) has been taken as:

- Investments value as at 31 March 2006 (£ mid-market value) £311,961,814 (2005: £280,073,205), plus
- the Trustee bank account balance as at 31 March 2006, plus certain other creditors and debtors, estimated as £231,090 prior to final accounts being prepared (2005: £12,924 in the audited accounts);
- assets in respect of insured pensions of £378,436 (2005: £390,465).

This leads to a total market value of assets as at 31 March 2006 of £312,571,340. (2005: £280,476,594). At the time of publication of this report, the net current assets for the year ended 31 March 2006 have not been finalised. However, this is not expected to affect materially the results shown.

The share of the overall Fund's assets notionally allocated to MDC is £1,680,000 (2005: £1,320,000). This has been calculated by taking the market value of assets notionally allocated to MDC as at 31 March 2003 for funding purposes and rolling forward this figure allowing for actual investment returns during the periods to 31 March 2005 and 2006. Further allowance has been made for contribution income (including special contributions) and pension payment outgoes over the period. Account has not been taken of Additional Voluntary Contributions for the purpose of these calculations. This is due to the fact that assets and liabilities are directly matched for these funds.

- The market conditions at balance sheet dates:

	31 March 2006	31 March 2005	31 March 2004
Merrill Lynch AA rated over 10 year corporate bond index	5.05%	5.43%	5.54%
Fixed interest 15 year index yield	4.32%	4.66%	4.73%
Index linked yield for over 5 years stocks, 0% inflation	1.40%	1.84%	1.90%

- The financial assumptions for both years are set out below:

	31 March 2006	31 March 2005	31 March 2004
Discount rate	5.1% pa	5.5% pa	5.5% pa
Price inflation	2.9% pa	2.8% pa	2.8% pa
Salary growth	4.4% pa	4.3% pa	4.3% pa
Pension increases (except on pre-88 GMP)	2.9% pa	2.8% pa	2.8% pa

- The following long-term return assumptions for each asset class is as follows:

	31 March 2006	31 March 2005	31 March 2004
Fixed Interest Gilts	4.3% pa	4.75% pa	4.75% pa
Index-Linked Gilts	1.4% pa real	1.75% pa real	2.0% pa real
Equities	7.75% pa	8.00% pa	8.00% pa
Bonds	5.1% pa	5.5% pa	n/a
Cash	4.5% pa	4.75% pa	4.0% pa

- The asset allocation and overall long-term return on the assets at the balance sheet dates are shown below (allowing for a long term inflation rate as set out above):

	Return 31.03.06	Allocation as at 31.03.06	Return 31.03.05	Allocation as at 31.03.05	Return 31.03.04	Allocation as at 31.03.04
Fixed Interest Gilts	4.3% pa	0%	4.75% pa	12.8%	4.75% pa	14.0%
Index-Linked Gilts	1.4% pa real	51.0%	1.75% pa real	42.2%	2.0% pa	real 51.9%
Equities	7.75% pa	41.2%	8.0% pa	32.7%	8.0% pa	33.2%
Bonds	5.1% pa	7.3%	5.5% pa	11.5%	n/a	-
Cash	4.5% pa	0.5%	4.75% pa	0.8%	4.0% pa	0.9%
Overall	5.8% pa	100%	5.9% pa	100%	5.8% pa	100%

FRS17 Results as at 31 March 2006, 31 March 2005 and 31 March 2004

	31 March 2006	31 March 2005	31 March 2004
Balance Sheet	£'000	£'000	£'000
Market value of assets	1,680	1,320	1,210
Liabilities:			
Active members	180	770	820
Deferred pensioners	750	590	455
Pensioners and dependants	890	nil	nil
Total	1,820	1,360	1,275
(Deficit) before any allowance for deferred tax liability	(140)	(40)	(65)

Analysis of the amount charged to operating profit:

	2006 £'000	2005 £'000
Current service cost	(185)	(40)
Past service cost	-	-
Total operating charge	(185)	(40)

Analysis of the amount charged to other interest:

	2006 £'000	2005 £'000
Expected return on pension scheme assets	80	70
Interest on pension liabilities	(75)	(70)
Net return	5	-

Analysis of the amount recognised in Statement of Total Recognised Gains and Losses (STRGL):

	2006	2005
	£'000	£'000
Actual return less expected return on assets	130	10
Experience gains and losses arising on the scheme liabilities	(70)	30
Changes in assumptions underlying the present value of scheme assets	(140)	–
Actuarial (loss) gain recognised in STRGL	(80)	40
Adjustment due to surplus cap	–	–
Net (loss) gain recognised	(80)	40

Movement in deficit between 31 March 2005 and 31 March 2006:

	2006	2005
	£'000	£'000
(Deficit) in scheme at the start of the year	(40)	(65)
Movement in year:		
– Current service costs	(185)	(40)
– Contributions	160	25
– Post service costs	–	–
– Net return on assets	5	–
– Actuarial (loss) gain	(80)	40
(Deficit) in scheme at the end of the year	(140)	(40)

History of experience gains and losses

	2006	2005
	£'000	£'000
Difference between the expected and actual return on scheme assets:		
– Amount	130	10
– Percentage of scheme assets	7.85	0.70%
Experience gains and losses on scheme liabilities:		
– Amount	(70)	30
– Percentage of the present value of scheme liabilities	(3.80%)	2.20%
Total amount recognised in the statement of total recognised gains and losses		
– Amount	(80)	40
– Percentage of the present value of scheme liabilities	(4.40%)	2.90%

Data is only available within the actuarial report for these two years.

Defined contribution pension scheme (NFU Mutual Insurance Society)

A defined contribution pension scheme was introduced in February 2001 to allow MDC employees to join a Group personal pension plan. Thirty-three employees have exercised this option (2005: 20). Contributions to the plan made by the MDC are in proportion to the employees' contributions. The Council's contribution to the plan is subject to a maximum of 12.5% of an employee's pensionable earnings as long as a contribution of 5% is made by the employee on the same earnings. Employees can contribute more than 5% of their pensionable earnings to the plan up to the limit established by statute. The assets of the scheme are held separately from those of the MDC, being invested with an insurance company. The pension cost represents contributions payable by the MDC to the insurance company and in the year ended 31 March 2006 amounted to £84,020 (2005: £67,123). There were no amounts outstanding to the insurance company at the year end.

26. RELATED PARTY TRANSACTIONS

Milk Development Council with associated and subsidiary companies

The Council members of the MDC also hold directorships in Milk Development Council Holdings Limited, a company limited by guarantee, formed in March 2001 to exploit the findings and technology emerging from research carried out by or on behalf of the Milk Development Council. This company has acquired participating shares of 90% and 20% respectively in Milk Development Council Evaluations Limited and Promise Fertility Limited. The results of Milk Development Council Holdings Limited and Milk Development Council Evaluations Limited are consolidated within these financial statements.

Milk Development Council Holdings Limited holds 90% of the issued share capital of Milk Development Council Evaluations Limited (MDCEL). One Council member (Trevor Lloyd) and the Chief Executive of the MDC (Kevin Bellamy) have been appointed to the Board of Directors of MDCEL. This company was formed in December 2001 to ensure the maintenance of a database of cattle for genetic evaluation to be calculated and the results to be disseminated among the industry. In the year ended 31 March 2006 MDC made grants of £484,000 (2005: £449,996) to MDCEL for the maintenance of the operational services for genetic evaluations.

Milk Development Council Holdings Limited holds 20% of the issued share capital of Promise Fertility Limited. The primary objective of this company is to provide a service to the dairy farmer by advising on the fertility of their animals. During the year ended 31 March 2006, the Chief Executive and the Head of Farm Management of the MDC (Kevin Bellamy and Brian Lindsay respectively) were on the Board of Directors of the company. A loan of £8,800 has been made by the MDC to Promise Fertility Limited. Provision has been made in case of the irrecoverability of this loan. During the year ended 31 March 2006 Promise Fertility Limited was in a dormant state.

All loans made to the above companies are repayable on demand.

The MDC provides various administrative, advisory and secretarial services to the above companies as agreed by the Council. No charges have been made for these services during the year ended 31 March 2006.

Milk Development Council Holdings Limited has also held 50% membership of The Dairy Council, a company limited by guarantee, with effect from 1 April 2003. The Dairy Council acts as an agency on behalf of the entire dairy industry in Great Britain, promoting the health benefits of milk and dairy products. MDC Holdings Ltd is entitled to three places on the board of directors. During the year ended 31 March 2006 Christian Fox was chairman of The Dairy Council, and Brian Peacock and Kevin Bellamy were directors of that company. In the year ended 31 March 2006 the MDC made grants of £275,004 (2005: £275,004) and other purchases totaling £134 (2005: £15,302) to The Dairy Council. As at 31 March 2006, MDC owed £23,148 (2005: £22,917) to The Dairy Council.

Chairman, council members, directors and key management of MDC and associated companies

During the year there were no material transactions or amounts owed by or due to any of the Council members or key management of the MDC, or with any members of their families.

Other related party transactions with organisations connected with past and present Council members or key management in excess of £1,000 are as follows:

- First Milk: the MDC match-funded the installation of school milk bars for £166,000 (2005: £353,000) and obtained no non-levy receipts (2005: £5,500). A Council member (William Campbell) is a local director of First Milk.
- Dynamic Conferences and Events arrange the MDC exhibits at trade shows, the cost of which in the period ended 31 March 2006 was £157,384 (2005: £99,083). The Chief Executive has informed the Council that the proprietors of this company are personal friends of his, and he will therefore take no part in their contractual relationship with the MDC.
- Holstein UK (HUK): two directors of Holstein UK (D Hewitt and T Gue) were also directors of MDCEL. During the year MDC paid HUK project costs of £30,821 (2005: 54,232), and MDCEL paid £45,298 (2005: £20,202) towards the operational costs for the dissemination of genetic information.
- Forgefirst Limited: consultancy fees on projects of £49,571 (2005: £27,488) were paid to this company. An ex-Council member (David Lattimore) who retired in February 2004 is a director of this company.
- Dairy UK: the MDC spent £22,853 (2005: £106,801) on projects and other purchases, and received £1,912 (2005: nil) towards projects with Dairy UK. A Council member (Gwyn Jones) is a director of Dairy UK.
- National Milk Records (NMR): MDC paid project costs to NMR of £6,018 (2005: £10,500 on project costs, and £49,058 for the purchase of office space and facilities). A Council member (Trevor Lloyd) is a non-executive director of NMR, and another Council member (David Homer) is a member of the Local Advisory Group for NMR. Two directors of MDCEL (A Warne and F Armitage) were also directors of NMR during the year. Mr Armitage also received £5,010 (2005: nil) from MDCEL for assistance during the production of genetics reports during the year.

- National Farmers' Union (NFU): MDC paid sundry costs of £3,904 (2005: £1,251) to the NFU, and £17,085 (2005: £12,665) to the NFU Mutual Insurance Society Limited for office and employee liability insurance. A Council member (Gwyn Jones) is chairman of the NFU Dairy Board, a member of the NFU Governance Board and an NFU Council member.
- Leatherhead Food International: project and subscription costs of £4,735 (2005: £20,570) were paid to this company. The Chairman of MDC (Brian Peacock) was also a director of Leatherhead Food International during the year ended 31 March 2006.
- Shilton Investments Limited: this company operates the chairman's office; costs in the year were £2,272 (2005: £2,661). The chairman is a director of Shilton Investments Limited.
- Taylerson Limited: consultancy fees on projects of £4,685 (2005: £16,962) were paid to this company. The previous Head of Market Development (John Taylerson) who resigned in October 2004 is a director of this company.
- Sarah Lindsay: the wife of MDC's Head of Farm Management received no fees during the year (2005: £4,400 for work as an educational author).

In all the above cases normal competitive bidding was observed before the award of the contract. The related parties within the MDC were not involved in the decision-making process.

Milk Development Council with other government bodies

MDC is a Non-Departmental Public Body (NDPB) funded by a statutory levy on milk producers and sponsored by the Department for Environment, Food and Rural Affairs (Defra). As such, transactions with government departments and other government bodies are considered to be related party transactions. Excluding payments to central and local authorities for tax, the following normal trading transactions, in excess of £1,000, are reported below for the year ended 31 March 2006.

MDC has been awarded a £1.5 million grant by the European Commission to match fund the Teenage Girls campaign (see Note 4). Payments of the grant to MDC are made through the Rural Payments Agency, an Executive Agency of Defra. Payments made to MDC in the year were £666,385 (2005: nil).

During the year MDC was awarded a grant from Defra not to exceed £386,000 over a three year period under The Agriculture Development Scheme, towards a project (Business Improvement in the Dairy Sector), to be carried out in collaboration with Dairy Farmers of Britain, Milklink Distribution Ltd and First Milk Ltd (see Note 5). Payments received in the year were £16,465 (2005: nil). In addition, Defra match-funded other project costs to the value of £126,969 (2005: £28,775). No payments were made to Defra in the year (2005: £4,400 for follow-up work on the quinquennial review).

MDC contributed £1,827 (2005: £1,200) to a project managed by the British Potato Council, a Non-Departmental Public Body sponsored by Defra.

MDC paid the Welsh Development Agency (WDA), a Non-Departmental Public Body, £49,362 (2005: £21,983) relating to administration of the Milkbench project. The WDA match-funded the cost of two school milk facilitators by paying the MDC £43,932 (2005: £29,795).

MDC paid £26,796 (2005: nil) to The National Audit Office for annual audit work relating to years 2003-04 and 2004-05. The National Audit Office is accountable to the Public Accounts Commission appointed by Parliament.

MDC paid £8,654 (2005: £8,951) to Historic Royal Palaces, a public body, for internal audit services.

No other payments were made to other government bodies in the year (2005: MDC paid £5,000 to University College, London, an NHS Trust, for research work on the Ketogenic Diet project).

There were no balances outstanding with the above organisations at year-end.

27. FINANCIAL INSTRUMENTS

FRS13 Derivatives and Other Financial Instruments requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities.

Because of the nature of its activities and the way in which the Milk Development Council is financed, it is not exposed to the degree of financial risks faced by other business entities. Moreover, financial instruments play a much more limited role than would be typical of the listed companies to which FRS13 mainly applies.

Financial assets and liabilities are generated by day-to-day operational activities and are not held to change the risks facing the Milk Development Council in undertaking its activities, or for trading. The fair values of all its financial assets and liabilities approximate to their net book values. In line with FRS13, short term debtors and creditors (those which mature or become payable within 12 months from the balance sheet date) have been excluded from these disclosures.

28. CONTINGENT LIABILITIES

The Milk Pension Fund, referred to in note 25, continues to give concern. In previous years the MDC has reported on the necessity of meeting substantial increases in employers' contributions in order to provide stability to this fund. The MDC has only two active members in the Fund, and the MDC bears a disproportionate cost in meeting its obligations to the Fund. The Council has taken advice and sought the views of the Treasury on the best course of action in order to minimise any future impact on the MDC, particularly since there are certain classes of deferred pensioners for whom the MDC could potentially become liable. A contingent liability of £1.4 million has been agreed by the Council to be used, if negotiations are successful, in order to eliminate this risk and settle all future obligations of the MDC to the Milk Pension Fund.

29. PRIOR YEAR ADJUSTMENTS

Prepaid rent

In the current year, the Council has changed the treatment of the prepaid rent amount to better reflect the nature of the prepayment. This has had the effect of decreasing debtors due within one year by £95,574 (2005: £134,887) and increasing debtors due in more than one year by the same amount (see Note 15).

Pension scheme liability

In the current year the Council has fully adopted FRS17 '*Retirement Benefits*' for the first time. This results in a pension liability of £140,000 being accounted for in the financial statements and a prior year adjustment of £40,000 reducing the brought forward reserves at 1 April 2005. The liability of £65,000 existing at 31 March 2004 has been incorporated via the retained surplus as shown in Note 20, and further information on the effect of FRS17 is explained in Note 25.

The Dairy Council

In the year the Council has applied FRS 9 '*Associates and Joint Ventures*' to The Dairy Council as it now has a participating interest in that entity. This results in an investment in associate company of £223,267 being accounted for in the financial statements and a prior year adjustment of £38,620 increasing the brought forward reserves at 1 April 2005. The surplus of £222,787 existing at 31 March 2004 has been incorporated via the retained surplus as shown in Note 20, and further information on the effect of this change is explained in Note 14.

The impact of the FRS17 and Dairy Council adjustments on the reported profit for the year ended 31 March 2005 is shown below:

	Group	Milk Development Council
	£	£
Previously reported surplus for the year ended 31 March 2005	(25,337)	106,059
– Pension contributions previously expensed	25,000	25,000
– Service cost expensed	(40,000)	(40,000)
– Expected return on plan assets	70,000	70,000
– Interest payable on scheme liabilities	(70,000)	(70,000)
Net effect of FRS17 adjustment	(15,000)	(15,000)
	(40,337)	91,059
Impact of recognition of The Dairy Council	38,620	–
Restated surplus for 2005	(1,717)	91,059

No deferred tax has been provided for in respect of the change in surplus due to the exemption from corporation tax as described in Note 11.

In addition to the above impact on the reported surplus, there has been a credit to reserves in 2005, reported through the Statement of Recognised Gains and Losses, of £40,000, representing the actuarial gain for that year.

The prior year adjustment has therefore impacted on the following areas:

	Group	Milk Development Council
	£	£
Pension scheme deficit at 1 April 2004, charged against opening reserves	(65,000)	(65,000)
Impact on Income & Expenditure account in 2005	23,620	(15,000)
Impact on STRGL in 2005	40,000	40,000
	(1,380)	(40,000)

ACCOUNTS DIRECTION

Accounts direction given by the Secretary of State, with the approval of the Treasury, in accordance with the Milk Development Order 1995, as amended.

The annual accounts shall give a true and fair view of the income and expenditure and cash flows for the financial year, and the state of affairs as at the year end. Subject to this requirement the Milk Development Council shall prepare accounts for the financial year ending 31 March 2006 and subsequent financial years in accordance with:

- a. Government Financial Reporting Manual (FReM);
- b. other guidance which the Treasury may issue from time to time in respect of accounts which are required to give a true and fair view;
- c. any other specific disclosures required by the Secretary of State; except where agreed otherwise with the Treasury, in which case the exception shall be described in the notes to the accounts.

Signed by the authority of the Secretary of State for Environment, Food and Rural Affairs.

APPLICATION OF THE ACCOUNTING AND DISCLOSURE REQUIREMENTS OF THE COMPANIES ACT AND ACCOUNTING STANDARDS

Schedule 1

Companies Act

1. The disclosure exemptions permitted by the Companies Act shall not apply to the Milk Development Council unless specifically approved by the Treasury.
2. The Companies Act requires certain information to be disclosed in the Directors' report. To the extent that it is appropriate, the information relating to the Milk Development Council shall be contained in the Foreword.
3. When preparing its Income and Expenditure account, the Milk Development Council shall have regard to format 2 of the Profit and Loss Account as prescribed in Schedule 4 to the Companies Act.
4. When preparing its balance sheet, the Milk Development Council shall have regard to the balance sheet format 1 prescribed in Schedule 4 to the Companies Act. The balance sheet totals shall be struck at "Total assets less current liabilities".
5. The Milk Development Council is not required to provide the additional information required by paragraph 33(3) of Schedule 4 to the Companies Act.
6. The Foreword and balance sheet shall be signed by the Accounting Officer and dated.

Accounting Standards

7. The Milk Development Council is not required to include a note showing historical cost profit and losses as described in Financial Reporting Standard (FRS) 3.

Schedule 2

1. The Foreword shall, inter alia:
 - a) include a statement that the accounts have been prepared in a form directed by the Ministers with the consent of Treasury in pursuance of the Industrial Organisation and Development Act 1947; and
 - b) include a brief history of the Milk Development Council and its statutory background.
2. The notes to the accounts shall include details of:
 - a) the key corporate financial targets set by Ministers together with the performance achieved; and
 - b) any write-offs and special payments.

MILK DEVELOPMENT COUNCIL information

Council Members

Mr B Peacock (Chairman)
Mr M Brearley
Mr W Campbell
Mrs R Collingborn
Mr C Fox
Mr I Gordon
Mr D Homer
Mr G Jones
Mr T Jones
Mr T Lloyd
Mr J Vickers

Specific Committees

Audit Committee

Mr T Jones (Chairman)
Mr M Brearley
Mr W Campbell
Mr J Vickers

Human Resources Committee

Mr J Vickers (Chairman)
Mr M Brearley
Mr C Fox
Mr G Jones

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