

# Directors' Report

## Dividend

The directors recommend a final dividend of 4.35p per ordinary stock unit payable on 10 February 2006 which, with the interim dividend of 4.05p already paid, makes a total of 8.40p for the year. The total dividend absorbs £17,548,000 leaving £3,040,000 to be transferred to revenue reserve.

## Business and Tax Status

The business of the company is that of a self-managed investment trust and it is registered as an investment company within the meaning of the Companies Act 1985. A review of the company's business during the year is given in the chairman's statement on page 4 and the management review on page 8.

The Inland Revenue has approved the company as an investment trust for the purposes of S842, Income and Corporation Taxes Act 1988 up to the accounting period ending 31 October 2004. The company has subsequently continued to satisfy the conditions for such approval.

## Stock Buybacks

During the year no ordinary stock was repurchased.

## Directors

The directors of the company at 31 October 2005 are shown on page 6. All directors served throughout the year except for James S MacLeod who was appointed on 1 September 2005.

The following table shows the attendance of directors at board and committee meetings during the year to 31 October 2005.

	Board	Audit	Remuneration	Nomination
Number of meetings	10	3	3	3
D C P McDougall	10	3	3	3
Sir George Mathewson	8	1	1	2
D F K Finlay	10	n/a	n/a	3
I H Leslie Melville	10	n/a	3	3
H N Buchan	9	2	n/a	3
J S MacLeod (appointed 1.9.05)	3	1	n/a	1
Sir Paul Nicholson (retired 28.1.05)	2	1	n/a	1

Sir George Mathewson retired from the audit and remuneration committees during the year and was replaced by Jim MacLeod and Hamish Buchan respectively.

The performance of each director has been appraised by the chairman in individual interviews during the year. The chairman's performance has been appraised in his absence by the other directors and the results have been communicated to him. The board believes that each director is independent of the management in character and judgement and that there are no relationships with the company or its employees which might compromise their independence.

Jim MacLeod was appointed to the board on 1 September 2005 on the recommendation of the nomination committee. The committee considered that his long experience of the financial services industry as a partner of Ernst & Young made him an excellent candidate for appointment to the board. No external agency was involved in the selection process. Mr MacLeod will stand for election at the AGM in accordance with the company's Articles of Association. The chairman recommends his election.

Three other directors are standing for re-election at the AGM. Sir George Mathewson, Francis Finlay and Hamish Leslie Melville have all served as directors for more than nine years and therefore retire on an annual basis. After formal performance evaluation, the chairman confirms that they continue to perform effectively and with great commitment and he recommends their re-election.

Biographical details of all directors appear on page 6.

Sir George Mathewson's appointment as a director runs for one year at a time. Francis Finlay and Hamish Leslie Melville were appointed as directors for fixed terms of three years in November 1996 which were renewed in November 1999 and November 2002 for a further three years. These appointments were renewed in November 2005 for a period of one year. Douglas McDougall was appointed for a fixed term of three years in September 1998 which was renewed in September 2001 and September 2004 for a further three years. Hamish Buchan was appointed in November 2003 and Jim MacLeod was appointed in September 2005 both for initial terms of three years. Directors' letters of appointment will be available for inspection at the AGM.

The company maintained liability insurance for its directors and officers throughout the year.

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## Directors' Interests

The interests of the directors and their families in the company's capital are as follows:

Beneficial interests	Ordinary stock units of 25p	
	31 October 2005	1 November 2004
D C P McDougall	60,000	60,000
Sir George Mathewson	57,983	18,383
D F K Finlay	60,000	60,000
I H Leslie Melville	60,000	60,000
H N Buchan	20,000	20,000
J S MacLeod	15,000	–
<b>Non-beneficial interests</b>		
Sir George Mathewson	26,500	13,200

There have been no changes in the directors' interests between 31 October 2005 and 12 December 2005.

## Corporate Governance

### Compliance

The board has considered the principles set out in the Combined Code on Corporate Governance ("the Combined Code") and believes that the way the company is governed is consistent with those principles. Throughout the year the company has complied with the provisions of the Combined Code except that there is no senior independent director. The directors consider that, where all directors are independent and non-executive, there is no compelling case for having a senior independent director.

### Directors

The board will normally meet eight times throughout the year while the audit and remuneration committees meet three times each. The nomination committee meets annually for performance appraisals and board review and as required to consider new appointments.

There is a schedule of matters reserved for the board which include investment strategy, accounting and financial controls, dividends and announcements, capital structure, gearing and major contracts.

All six members of the current board are non-executive and are independent of the company's management.

Day to day management, including the selection of investments, is delegated to the company's executive management which reports directly to the board.

All directors have been appointed for fixed terms not exceeding three years. All directors are required to retire by rotation at their first AGM and at intervals of not more than three years thereafter. No compensation is payable to a director who leaves the board before the expiry of his term of office. No

director has a service contract with the company. No contract or arrangement entered into by the company in which any director is interested has subsisted during the year.

The company has a policy on tenure which is shown on its website. It states that:

"All non-executive directors will be appointed for fixed terms of three years. Each director will be subject to re-election by the company in general meeting at least once every three years up to and including the ninth anniversary of his appointment.

"The performance of each director will be appraised by the nomination committee annually and prior to the renewal of a three year term. A more rigorous appraisal will take place prior to the second or subsequent renewal of a three year term.

"The directors recognise that independence is not a function of service or age and that experience is an important attribute within the board. The directors may decide to recommend a director with more than nine years service for re-election. In such a case, shareholder approval will be sought annually."

Prior to each board meeting directors are provided with a comprehensive set of papers giving detailed information on the company's transactions, financial position and performance. There is a procedure for directors to seek independent professional advice at the expense of the company and training is available to directors as required.

There is a nomination committee comprising the whole board for the purpose of selecting and appointing new directors and appraising board performance. It has written terms of reference which are shown on the company's website.

### Remuneration

The board has appointed a remuneration committee to recommend pay and conditions for the board and employees. It has written terms of reference which are shown on the company's website.

Directors' fees are set with a view to attracting individuals of appropriate calibre and experience, taking into account the level of fees paid by similar investment trusts. No other benefits are provided to directors. Fees recommended by the remuneration committee are subject to approval by the board and stockholders.

With regard to its employees, the company aims to provide levels of remuneration in line with similar organisations and to reward responsibility and achievement. Basic salaries are compared annually with those of equivalent employees in a group of comparable fund management organisations operating in Scotland. Remuneration consists of basic salary, a performance-related bonus and benefits including a contributory pension scheme.

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## *Relations with stockholders*

The company recognises the value of good communications with its stockholders. The management meets regularly with private client stockbrokers and the company's major institutional stockholders. The board receives regular briefings from the company's brokers. Newsletters are sent to stockholders during the year and are posted on the company's website. Stockholders are encouraged to attend the AGM and ask questions of the board and management. Any stockholder wishing to raise questions at other times should write to the chairman. Proxy voting figures for each resolution are announced to the meeting after voting on a show of hands. Separate items of business are proposed as separate resolutions including the receipt of the report and accounts and the approval of the directors' remuneration report. The annual report is sent to stockholders at least 20 working days before the AGM.

## *Accountability and audit*

The respective responsibilities of the directors and the auditors in respect of the financial statements are given on pages 24 and 27.

The audit committee, which normally meets three times per year, has written terms of reference which are shown on the company's website. Its duties include risk assessment, reviewing internal controls, the company's accounting policies, financial statements prior to their release and the company's procedures on whistleblowing. The committee is also responsible for all aspects of the company's relationship with its external auditors including reviewing the scope and effectiveness of the annual audit, the auditor's remuneration, the terms of engagement and the level of non-audit work, if any, carried out by the auditor. The committee will also ensure that the level of non-audit work does not compromise the auditor's independence.

The directors continue to believe that the financial statements should be prepared on a going concern basis as the assets of the company consist mainly of readily realisable securities.

The company does not have an internal audit function as the audit committee believes that the company's straightforward structure and small number of employees do not warrant such a function. This is reviewed by the committee every year.

The board is responsible for ensuring that the company has in place an effective system of internal controls designed to maintain the integrity of accounting records and safeguard the company's assets.

The board has applied Principle C.2 of the Combined Code by establishing a continuous process for identifying, evaluating and managing the

significant risks the company faces. This process, which has been in place throughout the year and up to and including the date of approval of this report is in accordance with Internal Control: Guidance for Directors on the Combined Code published in September 1999 (The Turnbull Guidance).

In compliance with Provision C.2 of the Combined Code, the board reviews the effectiveness of the company's system of internal control at six-monthly intervals. The board's monitoring covers all controls, including financial, operational and compliance controls and risk management. It is based principally on reviewing reports from management to consider whether significant risks are identified, evaluated, managed and controlled and whether any significant weaknesses are promptly remedied or indicate a need for more extensive monitoring. The audit committee assists the board in discharging its review responsibilities.

Detailed procedures are in place to ensure that:

- all transactions are accounted for accurately and reported fully to the board;
- the management observes the authorisation limits set by the board;
- there is a clear segregation of duties so that no investment transaction can be completed by one person;
- control activities are regularly checked;
- compliance procedures are in place for legal and regulatory obligations.

The board recognises that such systems can only provide reasonable, not guaranteed, assurance against material misstatement or loss.

## *Directors' responsibilities*

United Kingdom company law requires the directors to prepare financial statements for the year to 31 October 2005 which give a true and fair view of the state of affairs of the company and of the revenue and cash flows for that year. In preparing those financial statements, the directors are required to:

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act

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1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

The audit committee has reviewed the matters within its terms of reference and reports as follows:

- it has approved the financial statements for the year to 31 October 2005;
- it has reviewed the effectiveness of the company's internal controls and risk management;
- it has reviewed the need for a separate internal audit function;
- it has recommended to the board that a resolution be proposed at the AGM for the reappointment of the external auditors and it has considered the proposed terms of their engagement;
- it has satisfied itself as to the independence of the external auditors.

## Substantial Stockholdings

At 12 December 2005 the company had been notified of the following holdings in excess of 3% of its ordinary stock.

	Ordinary stock units	% of issue
Carrousel Capital	22,176,287	10.6
AXA Group	14,533,734	7.0
QVT	6,753,395	3.2
Legal & General	6,537,872	3.1
Lloyds TSB Group	6,532,468	3.1
D C Thomson	6,336,040	3.0

## Annual General Meeting

Resolutions relating to the following items of special business will be proposed at the forthcoming annual general meeting:

### *Amendment of the company's objectives*

As described in the chairman's statement, the board proposes to amend the company's objectives to the following: to provide investors, over the longer term, with above average returns through a diversified portfolio of international equities and to achieve dividend growth ahead of UK inflation.

### *Repurchase of the company's own ordinary stock*

At the annual general meeting of the company held on 28 January 2005 stockholders passed a resolution giving the company authority to make purchases of up to 31,315,686 ordinary stock units, being 14.99% of the then issued ordinary stock of the company. The authority is due to expire on 27 July 2006.

Resolution number 10 set out in the notice of annual general meeting seeks to renew the authority to repurchase ordinary stock until 26 April 2007. The principal reasons for such repurchases are to enhance the net asset value of the ordinary stock by repurchasing ordinary stock at prices which, after

allowing for costs, represent a discount to the prevailing net asset value and also to address any imbalance between the supply of and demand for ordinary stock.

Under the Listing Rules of the UK Listing Authority, the maximum price that may be paid on the exercise of the authority must not exceed the higher of (i) 105% of the average of the middle market quotations for the ordinary stock over the five business days immediately preceding the date of purchase, (ii) the price of the last independent trade and (iii) the highest current independent bid. The minimum price which may be paid is 25p per ordinary stock unit. Purchases of ordinary stock will be made in accordance with the new stock buyback policy set out in the chairman's statement.

The directors consider that it is in the best interests of the company to renew the authority to repurchase ordinary stock and recommend that stockholders vote in favour of the resolution.

## Voting Policy

The management reviews the business to be conducted at general meetings of the companies in which it invests and, wherever practicable, will cast its vote, usually by proxy.

## Socially Responsible Investing

When investments are made, the primary objective is to achieve the best investment return while allowing for an acceptable degree of risk. In pursuing this objective, various factors that may impact on performance are considered and these will include socially responsible investment issues. If it is considered that a company's social, environmental or ethical record will adversely affect financial performance and result in poor returns, then an investment will not be made in the company.

## Auditors

A resolution to re-appoint Deloitte & Touche LLP as the company's auditors, and to authorise the directors to fix their remuneration, will be proposed at the forthcoming annual general meeting.

## Payment of Creditors

It is the company's policy to agree in advance the terms of business with suppliers and then to abide by those terms.

As the company has no trade creditors, no disclosure can be made of creditor days at the year end.

## Donations

No charitable or political donations were made during the year.

By order of the board



**I M Harding**

Secretary  
12 December 2005